Spring -2022
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Education Scheme

CAF-02

TAX PRACTICES

Study Text
Examination Question / Answer

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BASIC CONCEPTS OF TAXATION

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1. Definition and Objective of Tax
2. Basis of Tax Laws
3. Tax as means for development
4. Kinds of Taxes
5. Principles for levy of tax
6. Characteristics of tax laws
7. The principles of a sound tax system
8. Types of taxes in Pakistan (i.e. Direct taxes and Indirect taxes)
9. History of Tax Laws in Pakistan

CHAPTER 1
BASIC CONCEPTS OF TAXATION

1. DEFINITION OF TAXATION AND OBJECTIVES OF TAXATION LAWS

Definition of tax

Tax is defined as follows:

1. Taxation is collection of share of individual and organization's income by Government under authority of law.
2. Taxation is used by Government for increasing revenue under authority of law to promote welfare and protection for its citizens.

Non-revenue objectives of taxation

The main purpose of taxation is to collect revenue for the Government. The Government levies tax to achieve following objectives.

1. To collect revenue to run and administer Government.
2. Tax is a tool for implanting its policies.
3. Tax is used for fair distribution of wealth.

In addition to finance Government expenses, tax is used as a tool to carry out national objective of social and economic development as follows:

1. Government can encourage the production of certain goods by introducing exemptions.
2. By charging high tax rates on imports the Government can encourage local purchase.
3. Taxes can be used to reduce inequalities in distribution of wealth.
4. Tax prevents wealth being concentrated in a few hands of the rich.
5. Through tax Government can encounter the effect of inflation and depression
6. To promote science and invention, education systems, health care systems, energy system and military defense.
7. It can be used to discourage investment abroad.
8. Tax can be used as a bargaining tool in trade negotiation with other countries.
9. Tax laws can be used for documentation of economy(Any amount transferred otherwise than banking channel will be deemed as income)
10. Government can discourage use of harmful goods by levying heavy rates of tax on certain sectors.
11. Tax can be used to discourage certain undesirable sectors and activities.
12. Government can encourage research & developments by introducing tax credits.

Question Explain the objectives of following tax laws?

Solution

Tax Law	Objective
Tax on salary income	Revenue Collection
Money transferred not through banking channel is considered as income	Documentation of economy
Tax on moveable assets of taxpayers	Fair distribution of wealth
Higher taxes on import of luxury goods	Reduction in imports of unnecessary goods
Allowing research as an expense	Promotion of research
Making exports exempt from tax	Promotion of Exports
Tax credit on Donations to approved institutions	To promote culture of payment of donation to only organized and regulated institutions
Tax credit on investments	Promote investments in listed companies
Tax exemptions to software exports	Promote software Industry

Note; Students should memorize it.

2. BASIC CONCEPTS

Basics of tax laws

Adam Smith's in his famous book "Wealth of Nations" has elaborated following canons of taxation:

Equality

Tax payments should be proportional to income.

Certainty

Tax payable should be clear and certain to taxpayer.

Convenience of payment

Tax should be collected from taxpayer at a convenient time.

Economy of collection

Taxes should not be expensive to collect.

2.1 Tax as means for development

Tax is a main source of development. Tax helps in the development of country as follows:

1. Tax incentives for agro based projects promote agriculture.
2. Charities can be encouraged by providing tax credits on them.
3. Imposing high custom duties on import of luxury items will encourage local manufacturing.
4. Taxing rich at higher rate and low income group at lower rate.
5. Government can mark areas as tax free zones, industrial zone and economic zone to provide tax incentives to such areas. It will encourage business concerns to establish business units that will bring employment opportunities.
6. Investment in new shares can be encouraged through introducing tax credits.
7. Investment in new plant and machinery can be encouraged through introduction of tax credits.

2.2 Kinds of taxes/Structure of taxes

Proportional tax/ Flat tax

It is a tax where the rate of tax is fixed. A fixed rate is applied on person's income whether the income is high or low. Under this system people who earn more are not charged at a higher percentage as compared to progressive tax.

Progressive tax

It is a tax in which the tax rate increases as the income base increases. A progressive tax takes a larger amount of tax from the high-income group as compared to low-income group. This tax proportionately equal to a person's status in the society.

Regressive tax

It is a tax where tax rate decreases as the amount of income increases. The higher income group pays less in taxes than the lower income group. Regressive taxes impose greater tax burden on the poor.

2.3 Principles for levy of tax

Following are the principles for levy of tax.

The Benefit Principle

This principle says that taxes should be based on the benefits received. It means that those who receive the greatest benefits from Government projects should pay the most taxes. The benefit principle is commonly used for highways, libraries, etc.

The Ability-to-Pay principle

The tax should be based on ability to pay. It means that a person who is earning more income should pay more tax. Progressive tax rates are an example of it.

The Equal Distribution Principle

It says that incomes and transactions should be taxed at a fixed rate. Therefore, people who are earning more income shall pay more tax but not at higher rate.

2.4 Characteristics of tax laws

Following are some of the characteristics of a taxation system:

1. Administration and compliance costs should be low.
2. It should be understandable to the taxpayer.
3. The burden of taxes should be distributed in proportion to the ability of the tax-payer, i.e., it should be progressive in character.
4. The tax should be payable in cash. It means that payment through cheques should not be accepted.

5. It should be mandatory in nature and payment should not be voluntary in nature.
6. Taxes should be collected at a convenient time for tax payers.
7. Tax should be imposed by state which has the jurisdiction over the person to recover i.e. it should be imposed by Parliament in Pakistan.
8. It is levied for public purpose i.e. taxes are imposed to support Government to implement projects.
9. Taxes should be charged on incomes, transactions or property.

2.5 The principles of a sound tax system

1. Fiscal adequacy
   The sources of revenue should be sufficient to meet expenses of government. Revenues of Government should be capable of expanding or contracting annually in response to variations in public expenditures.
2. Equality or Theoretical Justice
   Taxes charged must be based upon the ability of the citizen to pay.
3. Administrative Feasibility
   Tax laws should be clear and plain to taxpayers. Capable and well-trained public officers should enforce it. Time of payment should be convenient.
4. Consistency or Compatibility with Economic Goals
   Tax laws should be consistent with economic goals of the government. The goal of Government is to provide basic services for general public.

3. TYPES OF TAXES IN PAKISTAN

Federal taxes in Pakistan are classified into 2 broad categories:

1. Direct taxes
2. Indirect taxes

Direct Taxes

Income Tax

Income tax is imposed for each tax year, at specified rates on every person who has taxable income for the year. Taxable income for charge of tax is divided under the following heads:

a) Salary;
b) Income from Property;
c) Income from Business;
d) Capital Gains; and
e) Income from Other Sources.

Capital Value Tax

Capital value tax on different transaction such as transfer of immoveable property, transfer of rights etc.

Indirect Taxes

Sales Tax

Sales tax is charged and paid at the rate of 17% of the value of--

a) taxable supplies made by a registered person in the course of any taxable activity carried on by him; and
b) goods imported into Pakistan.

For determining tax liability input paid at the time of purchase or import is deducted from output tax charged on sales.

Customs Duty

Customs Act in Pakistan specifies import and export duties on certain goods. A major portion of Government's revenue is collected through this tax. The rate of custom duty is determined by socio-economic factors. Under this Act high rate is applied on luxury items as well as less essential goods. The import tariff on industrial plant and machinery is lower than that of consumer goods.

Federal Excise Duty

Under Federal Excise Act tax is charged at specified rate on:

- Goods produced or manufactured in Pakistan
- Goods imported in Pakistan
- Services provided in Pakistan

The base on which tax is charged may be value or retail price or weight. Classification of goods is done as per Harmonized Commodity Description and Coding system. All exports are charged to tax at the rate of zero percent.

4. HISTORY OF TAX LAWS IN PAKISTAN

In Pakistan Federal Government has the right to collect tax on the income of a person.

The history of modern tax came from year 1860. Before the partition, income tax was introduced for the first time in 1860. The British Empire first introduced the Income Tax Act 1860 to fulfill the deficit faced due to war of independence of 1857. The tax was repealed in 1865.

Thereafter Income Tax Act of 1886 was introduced and it was imposed on traders by some of provinces. Its basic scheme survives till today. It introduced the definition of agricultural income and it was made exempt from tax and the exemption is applicable till now.

After the World War, the Government required more funds. So in 1916 for the first time progressive rates of tax were introduced. Government thought that flat rates of taxes are not justified and the amount of the tax levied should depend upon the income of the earner. For collecting additional resources, a Super Tax was levied in 1917.

The most comprehensive tax introduced was Income Tax 1922 in which income tax and super tax were consolidated. Its salient features were:

- Rates to be decided every year through Finance Act.
- In certain cases tax withholding was made mandatory.
- Re-opening of assessment was allowed.

After independence, the Government of Pakistan adopted this Act.

Till 1979, lot of amendments took place in Income Tax Act, 1922. Resultantly, the Act became a complicated law.

Keeping in view the difficulties, the Government promulgated a new income tax law namely "The Income Tax Ordinance, 1979". This law was amended through number of finance acts and after 23 years of its existence, a new law was promulgated termed as "Income Tax Ordinance, 2001. The fundamental change introduced was the introduction of a regime of Universal Self-Assessment Scheme.

This law has also been amended through number of finance acts and changes are still going on.

ICAP PAST PAPER QUESTIONS

Question-1

The primary objective of a taxation system is to collect revenue. You are required to list the other objectives (non-revenue) which a taxation system can achieve. **(10)**

(Q.7 September 2014)

Question-2

State any five ways through which taxes can be used for development of the country. **(05)**

(Q.9 March 2015)

Question-3

Briefly explain any three indirect taxes applicable in Pakistan. **(05)**

(Q.10 March 2015)

Question -4

Besides financing government operational expenditures, taxation is also utilized as a tool to carry out the national objective of social and economic development. List any five non-revenue objectives of taxation. **(05)**

(Q.7 (b) March 2016)

Question -5

Taxes are primary revenue yielding tools of the Government of modem ages. You are required to state any **three** non-revenue objectives which the Government achieves by imposing taxation. **(03)**

(Q.5 March 2018)

Question -6

(a) Briefly explain indirect taxes applicable in Pakistan. **(04)**

(b) State **one** objective of tax laws in each of the following cases:

- (i) High tax rate on high income
- (ii) Higher taxes on import of luxury goods
- (iii) Tax credit on donations to approved institutions
- (iv) Tax credit on investments
- (v) Creation of tax free zones
- (vi) Tax on income of individuals and companies
- (vii) Tax on transactions not made through normal banking channel
- (viii) Zero rating under the Sales Tax Act, 1990 **(06)**

(Q.7 September 2018)

Question-7

(a) Briefly discuss **three** broad principles for levy of taxes. **(04)**

(b) Briefly explain any **three** indirect taxes applicable in Pakistan. **(05)**

(Q.8 September 2019)

Question-8

Taxes are primary revenue yielding tools of the Government of modern ages. State any **five** ways by which taxes can be used for the development of the country. **(05)**

(Q.8(a) March 2021)

ICAP PAST PAPER SOLUTIONS

Answer-1

Non-revenue objectives of taxation

Though the main purpose of taxation is to collect revenue for the Government, but in addition the Government has certain non-revenue objectives which are listed below:

1. Government can encourage the production of certain goods by introducing exemptions.
2. By charging high tax rates on imports the Government can encourage local purchase.
3. Taxes can be used to reduce inequalities in distribution of wealth.
4. Tax prevents wealth being concentrated in a few hands of the rich.
5. Through tax Government can encounter the effect of inflation and depression
6. To promote science and invention, education systems, since and invention, health care systems, energy system and military defense.
7. It can be used to discourage investment abroad.
8. Tax can be used as a bargaining tool in trade negotiation with other countries.
9. Tax laws can be used for documentation of economy(Any amount transferred otherwise than banking channel will be deemed as income)
10. Government can discourage use of harmful goods by levying heavy rates of tax on certain sectors.
11. Tax can be used to discourage certain undesirable sectors and activities.
12. Government can encourage research & developments by introducing tax credits.

Answer-2

Tax as means for development

Tax helps in the development of economy as follows:

1. Tax incentives for agro based projects promote agriculture.
2. Charities can be encouraged by providing tax credits on them.
3. Imposing high custom duties on import of luxury items will encourage local manufacturing.
4. Taxing rich at higher rate and low income group at lower rate.
5. Government can mark areas as tax free zones, industrial zone and economic zone to provide tax incentives to such areas. It will encourage business man to establish business units that will bring employment opportunities.
6. Investment in new shares can be encouraged through introducing tax credits.
7. Investment in new plant and machinery can be encouraged through introduction of tax credits.

Answer-3

Indirect Taxes

Sales Tax Act, 1990

Sales tax is charged and paid at the rate of 17% of the value of--

c) taxable supplies made by a registered person in the course or furtherance of any taxable activity carried on by him; and

d) goods imported into Pakistan.

For determining tax liability input paid at the time of purchase or import is deducted from output tax charged on sales.

Customs Act, 1990

Customs Act in Pakistan specifies certain import and export duties on goods. A major portion of Government's revenue is collected through this tax. The rate of custom duty is determined by socio-economic factors. Under this Act high, rate is applied on luxury items as compared to others. The import tariff on industrial plant and machinery is lower than that of consumer goods.

Federal Excise Act, 1990

Under Federal Excise Act tax is charged at specified rate on:

- Goods produced or manufactured in Pakistan
- Goods imported in Pakistan
- Services provided in Pakistan

The base on which tax is charged may be value or retail price or weight. Classification of goods is done as per Harmonized Commodity Description and Coding system. All exports are charged to tax at the rate of zero percent.

Answer-4
Refer Answer-1

Answer-5
Refer Answer-1

Answer-6

a) **Indirect Taxes**

Sales Tax Act,1990

Sales tax is charged and paid at the rate of 17% of the value of--

a) taxable supplies made by a registered person in the course of any taxable activity carried on by him; and

b) goods imported into Pakistan.

For determining tax liability input paid at the time of purchase or import is deducted from output tax charged on sales.

Customs Act,1990

Customs Act in Pakistan specifies import and export duties on certain goods. A major portion of Government's revenue is collected through this tax. The rate of custom duty is determined by socio-economic factors. Under this Act high rate is applied on luxury items as well as less essential goods. The import tariff on industrial plant and machinery is lower than that of consumer goods.

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Under Federal Excise Act tax is charged at specified rate on:

- Goods produced or manufactured in Pakistan
- Goods imported in Pakistan
- Services provided in Pakistan

The base on which tax is charged may be value or retail price or weight. Classification of goods is done as per Harmonized Commodity Description and Coding system. All exports are charged to tax at the rate of zero percent.

b)

i. To reduce inequalities in distribution of wealth.
ii. Reduction in imports of unnecessary goods.
iii. To promote culture of payment of donations to only organized and regulated institutions.
iv. To promote investments in listed companies.
v. To encourage business concerns to establish business units that will bring employment opportunities.
vi. To generate revenue.
vii. Documentation of economy
viii. Promotion of exports.

Answer-7

(a) Refer Heading 2.3 of Chapter.
(b) Refer Heading 3 of Chapter and only write down indirect taxes.

Answer-8
Refer Answer-2

CONSTITUTIONAL PROVISIONS

2

FEDERAL FINANCIAL PROCEDURES

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5. Procedure relating to Annual Budget Statement [82]
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PROVINCIAL FINANCIAL PROCEDURES

12. Provincial Consolidated Fund and Public Account [118]
13. Custody, etc., of Provincial Consolidated Fund and Public Account [119]
14. Annual Budget Statement [120]
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22. National Finance Commission [160]
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29. Powers of the Federation to legislate on taxes
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CHAPTER 2
CONSTITUTIONAL PROVISIONS

FEDERAL FINANCIAL PROCEDURES

Federal Consolidated Fund and Public Account [78]

(1)
- All revenues received/loans raised by the Federal Government and
- Amount received in repayment of loan,

shall be credited to Federal Consolidated Fund.

(2) All other moneys-
(a) received by the Federal Government; or
(b) deposited with the Supreme Court/any other court;
shall be credited to the Public Account of the Federation.

Custody, etc., of Federal Consolidated Fund and Public Account [79]

- The custody of the Federal Consolidated Fund and Public Account of the Federation, the payment and withdrawal from the Funds,
- all other connected matters

shall be regulated by Act of Majlis-e-Shoora (Parliament) or rules made by President.

Annual Budget Statement [80]

(1) In each financial year, the Federal Government shall lay before the National Assembly a statement of the estimated receipts and expenditures of the Government. It will be called as Annual Budget Statement.

(2) The Annual Budget Statement shall show separately-
(a) amounts required to meet expenses charged by Constitution on Federal Consolidated Fund;
(b) amounts required to meet other expenses proposed to be made from Federal Consolidated Fund; and
shall distinguish between revenue expenses and other expenses.

Expenditure charged upon Federal Consolidated Fund [81]

The following expenditures shall be charged upon the Federal Consolidated Fund:-

(a) the remuneration of President and other expenses of his office, and the remuneration of-
  (i) the Judges of the Supreme Court and the Islamabad High Court;
  (ii) the Chief Election Commissioner;
  (iii) the Chairman and the Deputy Chairman;
  (iv) the Speaker and the Deputy Speaker of the National Assembly;
  (v) the Auditor-General;

(b) The admin expenses, including the remuneration of officers and servants of Supreme Court, the Islamabad High Court, the department of the Auditor-General, the Office of the Chief Election Commissioner and the Secretariats of the Senate and the National Assembly.

(c) Debt charges of the Federal Government, including interest, the repayment of capital, and other expenses for raising loans, and redemption of debt on the security of Federal Consolidated Fund;

(d) amount paid for any judgment/order against Pakistan by any court or tribunal; and

(e) any other amount declared by the Constitution or by Act of Majlis-e- Shoora (Parliament).

Procedure relating to Annual Budget Statement [82]

(1) Expenses charged on Federal Consolidated Fund in Annual Budget Statement shall be discussed in the National Assembly. A voting will not be required.

(2) Other expenses in Annual Budget Statement shall be submitted to National Assembly for raising grant. The Assembly may or may not agree to demand. It may also reduce the demand.

(3) The demand can only be made with recommendation of Federal Government.

Authentication of schedule of authorised expenditure [83]

(1) The Prime Minister shall sign a schedule specifying-
 (a) the grants made by the National Assembly (under Article 82), and
 (b) amounts required for expenses charged on the Federal Consolidated Fund. It shall not exceed the amount mentioned in statement previously laid before the National Assembly.

(2) The authenticated schedule (as above) shall be laid before National Assembly. It shall not be open for discussion or vote.

(3) An expense from Federal Consolidated Fund shall be considered as authorized when above procedure is followed.

Supplementary and excess grants [84]

If in a financial year it is found-

(a) that authorized expense for a service is insufficient, or expense for a new service is required which is not included in the Annual Budget Statement; or

(b) that amount spent on any service exceeds the amount granted;

the Federal Government can authorize expenditure from the Federal Consolidated Fund. For this, Federal Government shall lay before National Assembly a Supplementary or Excess Budget Statement.

Votes on account [85]

The National Assembly can make grant in advance of estimated expenditure for a part of financial year, not more than 4 months, if the authentication of schedule is pending (in accordance with the provisions of Article 83).

Power to authorise expenditure when Assembly stands dissolved [86]

If National Assembly is dissolved, the Federal Government may authorize expense from the Federal Consolidated Fund for estimated expenditure for a period of not more than 4 months in financial year, if the authentication of the schedule of authorized expenditure is pending (in accordance with the provisions of Article 83).

Secretariats of Majlis-e-Shoora (Parliament) [87]

(1) Each House shall have a separate Secretariat:
 However posts common to both Houses can be awarded.

(2) Majlis-e-Shoora (Parliament) may regulate recruitment of persons appointed to the Secretarial staff of both Houses.

(3) The Speaker or the Chairman may, with the approval of the President, make rules regulating the recruitment of persons appointed to the secretarial staff of both Houses.

Finance Committees [88]

(1) The expenditure of the National Assembly and Senate shall be controlled by the National Assembly or Senate acting on the advice of its Finance Committee.

(2) The Finance Committee shall consist of the Speaker or the Chairman, the Minister of Finance and other members elected by the National Assembly or the Senate.

(3) The Finance Committee may make rules for regulating its procedure.

PROVINCIAL FINANCIAL PROCEDURES

Provincial Consolidated Fund and Public Account [118]

(1)
- All revenues received/loans raised by the Provincial Government and
- amount received by it in repayment of loan,

shall form part of Provincial Consolidated Fund.

(2) All other moneys-
(a) received by the Provincial Government; or
(b) received with the High Court/any other court;
shall be credited to the Public Account of the Province.

Custody, etc., of Provincial Consolidated Fund and Public Account [119]

- The custody of the Provincial Consolidated Fund, the payment and withdrawal from the Fund,
- the custody of Public Account of the Province, the payment and withdrawal from the Fund and
- all other connected matters shall be regulated by Act of the Provincial Assembly or provisions made by Governor in this behalf.

Annual Budget Statement [120]

(1) In each financial year, the Provincial Government shall lay before the Provincial Assembly a statement of the estimated receipts and expenditures of the Government. It will be called as Annual Budget Statement.

(2) The Annual Budget Statement shall show separately-
(a) amounts required to meet expenses charged by Constitution on Provincial Consolidated Fund;
(b) amounts required to meet other expenses proposed to be made from Provincial Consolidated Fund; and shall distinguish expenditure on revenue account from other expenditure.

Expenditure charged upon Provincial Consolidated Fund [121]

The following expenditures shall be charged upon the Provincial Consolidated Fund:-
(a) the remuneration of Governor and other expenses of his office, and the remuneration of-
(i) the Judges of the High Court;
(ii) the Speaker and the Deputy Speaker of the Provincial Assembly;
(b) The administrative expenses, including the remuneration of officers and servants of the High Court, and the Secretariat of the Provincial Assembly.
(c) Debt charges of the Provincial Government, including interest, the repayment or amortisation of capital, and other expenses for raising of loans, and the service and redemption of debt on the security of Provincial Consolidated Fund;
(d) amount paid for any judgment/order against Province by any Court or tribunal; and
(e) any other amount declared by the Constitution or by Act of Provincial Assembly.

Procedure relating to Annual Budget Statement [122]

(1) Expenses charged on Provincial Consolidated Fund in Annual Budget Statement shall be discussed in the Provincial Assembly. However a voting will not be required.

(2) Other expenses appearing in Annual Budget Statement shall be submitted to the Provincial Assembly for raising grant. The Assembly may or may not agree to the demand of grant. It may also reduce the demand.

(3) The demand for a grant can only be made with the recommendation of the Provincial Government.

Authentication of schedule of authorized expenditure [123]

(1) The Chief Minister shall sign a schedule specifying-
(a) the grants made by the Provincial Assembly (under Article 120), and
(b) amounts required to meet the expenses charged on the Provincial Consolidated Fund. It shall not exceed the amount mentioned in the statement previously laid before the Provincial Assembly.

(2) The authenticated schedule (as above) shall be laid before the Provincial Assembly. It shall not be open for discussion or vote.

(3) An expense from the Provincial Consolidated Fund shall be considered as authorized when it is specified in the authenticated schedule and schedule is laid before the Provincial Assembly (as required by clause (2)).

Supplementary and excess grant [124]
If in a financial year it is found-
(a) that authorized expense for a particular service is insufficient, or expense for a new service is required which is not included in the Annual Budget Statement; or
(b) that amount spent on any service exceeds the amount granted;
the Provincial Government has power to authorize expenditure from the Provincial Consolidated Fund. For this, Provincial Government shall lay before the Provincial Assembly a Supplementary Budget Statement or an Excess Budget Statement specifying the amount of expenditure.

Votes on account [125]
The Provincial Assembly can make any grant in advance of estimated expenditure for a part of financial year, not more than 3 months, if the authentication of the schedule of authorized expenditure is pending (in accordance with the provisions of Article 123).

Power to authorize expenditure when Assembly stands dissolved [126]
If Provincial Assembly is dissolved, the Provincial Government may authorize expenditure from the Provincial Consolidated Fund for estimated expenditure for a period of not more than 4 months in the financial year, if the authentication of the schedule of authorized expenditure is pending (in accordance with the provisions of Article 123).

Provisions relating to National Assembly, etc., to apply to Provincial Assembly, etc [127]
The provisions of Article 87 and 88 shall apply to Provincial Assembly or the Provincial Government in a way that:
(a) any reference to Majlis-e-Shoora (Parliament), a House or the National Assembly shall be read as a reference to the Provincial Assembly;
(b) any reference to the President shall be read as a reference to the Governor of the Province;
(c) any reference to the Federal Government shall be, read as a reference to the Provincial Government;
(d) any reference to the Prime Minister shall be read as a reference to the Chief Minister;
(e) any reference to the National Assembly shall be read as a reference to the Provincial Assembly; and

DISTRIBUTION OF REVENUES BETWEEN FEDERATION AND PROVINCES

National Finance Commission [160]

(1) *Constitution of NFC/Who may be member of NFC*
The President shall, at intervals not exceeding 5 years, constitute a National Finance Commission consisting of:
- the Minister of Finance of the Federal Government,
- the Ministers of Finance of the Provincial Governments, and
- such persons as appointed by President after consultation with Governors of the Provinces.

(2) *Duties of NFC*
It shall be the duty of the National Finance Commission to make recommendations to President regarding-
(a) the distribution of tax receipts between the Federation and the Provinces (as in clause (3));
(b) the making of grants-in-aid by the Federal Government to the Provincial Governments;
(c) the exercise by the Federal Government and the Provincial Governments of the borrowing powers; and
(d) any other finance matter referred by the President.

(3) *Taxes raised by Parliament*
The taxes (referred to in paragraph (a) of clause (2)) raised under authority of Majlis-e-Shoora (Parliament) are as follows: -
(i) taxes on income, including corporation tax, but not including taxes on income consisting of remuneration paid out of the Federal Consolidated Fund;
(ii) taxes on sales and purchases of goods imported, exported, manufactured or consumed;
(iii) export duties on cotton, and such other export duties as specified by the President;
(iv) such duties as specified by the President; and
(v) such other taxes as specified by the President.

(3A) The share of the Provinces in each Award (recommendation) of National Finance Commission shall not be less than the share in the previous Award.

(3B) The Federal Finance Minister and Provincial Finance Ministers shall monitor the implementation of the Award biannually and lay their reports before both Houses of Majlis-e-Shoora (Parliament) and Provincial Assemblies.

(4) *Order by President*
On the basis of recommendation of the National Finance Commission, the President shall, specify:
- the share of the tax receipts which is to be allocated to each Province and
- that share shall be paid to the Government of the Province concerned, and,.
- share shall not form part of the Federal Consolidated Fund.

(5) The recommendations of the National Finance Commission shall be laid before both Houses and the Provincial Assemblies.

(6) Before any order regarding share of tax receipts (under clause (4)) the President may, make such amendments in the law relating to the distribution of revenues between the Federal Government and the Provincial Governments as he considers necessary.

(7) The President may, by order, make grants-in-aid to the Provinces in need of assistance and such grants shall be charged upon the Federal Consolidated Fund.

Natural gas and hydro-electric power [161]

1)
(a) the net proceeds (receipts) of:
- Federal excise duty on natural gas charged at well-head and
- royalty collected by the Federal Government

shall not form part of the Federal Consolidated Fund and shall be paid to the Province where well-head is located;

(b) the net proceeds of Federal excise duty on oil charged at well-head shall not form part of the Federal Consolidated Fund and shall be paid to the Province where well-head is located.

2) The net profits earned from the bulk generation of power at a hydro-electric station shall be paid to the Province.
Explanation - "net profit" means revenue from supply of power less operating expenses (including taxes, duties, interest, and depreciations and element of obsolescence).

Prior sanction of President to Bills affecting taxation in which Provinces are interested [162]
Following bills will not be moved in the National Assembly without sanction of the President.
A bill which:
- imposes/varies a tax, the proceeds of which is allocated to any Province, or
- varies the meaning of the "agricultural income" for charging income-tax, or
- affects the principles on which moneys are distributed to Provinces,

Provincial taxes in respect of professions, etc [163]
A Provincial Assembly may impose taxes, not exceeding limits specified by Majlis-e-Shoora (Parliament), on persons engaged in professions, trades or employments.

Grants out of Consolidated Fund [164]
The Federation or a Province may make grants for any purpose.

Exemption of certain public property from taxation [165]

(1) The Federal Government is not liable to pay tax on its property or income under any Act of Provincial Assembly.
A Provincial Government is not liable to pay tax on its property or income under:
- Act of Majlis-e-Shoora (Parliament) or
- Act of the Provincial Assembly of other Province.

(2) If any trade/business is carried on by a Provincial Government outside Province, that income may be taxed under Act of Majlis-e-Shoora (Parliament) or Act of the Provincial Assembly where business is carried on.

(3) However fee for services can be imposed.

Power of Majlis-e-Shoora (Parliament) to impose tax on the income of certain corporations, etc [165(A)]

(1) Majlis-e-Shoora (Parliament) can make law for charging of tax on the income of a company established by or owned or controlled by a Federal or a Provincial Government.

(3) Order of court, including the Supreme/High Court, which conflicts with above provision shall be void.

FEDERAL LEGISLATIVE LIST

Powers of the Federation to legislate on taxes (Areas whereby Federal Government can legislate to levy taxes)

Following entries in the Federal legislative list contained in constitution of Pakistan relates to taxes or following are the taxes which can be imposed by the Federation.

43. Duties of customs, including export duties.
44. Duties of excise, including salt, but not including alcoholic liquors, opium or other narcotics;
47. Taxes on income other than agricultural income;
48. Taxes on corporations.
49. Taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed, except sales tax on services.
50. Taxes on the capital value of the assets, not including taxes on immovable property.
51. Taxes on mineral oil, natural gas and minerals for use in generation of nuclear energy.
52. Taxes and duties on the production capacity of any plant, machinery, undertaking
53. Terminal taxes on goods or passengers carried by railway, sea or air; taxes on their fares and freights.

Using above provisions, following laws are enacted by the Federal Government:

Legislative powers of Federation	Laws enacted thereunder
Taxes on income other than agricultural income Taxes on corporations Taxes on mineral oil, natural gas and minerals for use in generation of nuclear energy.	Income Tax Ordinance,2001
Taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed, except sales tax on services Taxes and duties on the production capacity of any plant, machinery or installation of any one or more of them.	Sales Tax Act, 1990, Federal Excise Act, 2005, Customs Act,1969
Taxes on the capital value of the assets, not including taxes on immovable property.	Capital Value Tax levied through Finance Act, 1989

Powers of the Provinces to legislate on taxes (Areas where Provincial Government can legislate to levy taxes)

All taxes other than the mentioned in above list of Federal legislative list as contained in the Constitution of Pakistan are covered in the scope of legislation of Provinces. Accordingly, various types of taxes are introduced by the Provinces:

- Sales tax on services
- Taxes on transfer of immoveable property
- Professional tax
- Tax on luxury houses
- Tax on registration of luxury vehicles etc.
- Property tax

ICAP PAST PAPER QUESTIONS

Question-1

(a) List the taxes which can be imposed by the Federal Government. **(6)**

(b) Briefly describe the duties of National Finance Commission. **(4)**

(Q.9 September 2014)

Question-2

What do you understand by 'Federal consolidated fund'? Enumerate the expenditures which are charged upon the Federal consolidated fund. **(8)**

(Q.8 September 2015)

Question -3

Under the provisions of Article 160 of the Constitution of Pakistan, briefly describe the formation of 'National Finance Commission'. Who may be the member(s) of such Commission? **(3)**

(Q.7(a) March 2016)

Question-4

List any five types of taxes which can be imposed by the Federation as provided in the Federal legislative list under the Constitution of Pakistan. **(05)**

(Q.7 (b) September 2016)

Question-5

(a) State the duties of National Finance Commission. **(04)**

(b) List the taxes and duties which may be raised under the authority of Parliament. Also list various types of taxes which are covered under the scope of legislation of the Provinces. **(06)**

(Q.4 March 2017)

Question-6

List any five taxes which can be imposed by the Federal Government. **(05)**

(Q.5 (b) March 2018)

Question-7

(a) National Finance Commission has the duty to make recommendations to the President with regard to finance related matters. You are required to list such recommendations. **(04)**

(b) State the taxes and duties which may be raised under the authority of Parliament. Also state **four** types of taxes which are covered:

(i) under the scope of legislation of the Federation

(ii) under the scope of legislation of the Provinces. **(06)**

(Q.8 March 2019)

Question-8

List six types of taxes which are covered within the legislative powers of Provinces. **(03)**

(Q.8(b) March 2021)

ICAP PAST PAPER SOLUTIONS

Answer-1

a) Following are the taxes which can be imposed by Federation

1. Duties of customs, including export duties.
2. Taxes on income other than agricultural income;
3. Taxes on corporations.
4. Taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed, except sales tax on services.
5. Taxes on the capital value of the assets, not including taxes on immovable property.
6. Taxes on mineral oil, natural gas and minerals for use in generation of nuclear energy.
7. Taxes and duties on the production capacity of any plant, machinery, undertaking
8. Terminal taxes on goods or passengers carried by railway, sea or air; taxes on their fares and freights.

b) It shall be the duty of the National Finance Commission to make recommendations to the President regarding-

(e) the distribution of tax receipts between the Federation and the Provinces;
(f) the making of grants-in-aid by the Federal Government to the Provincial Governments;
(g) the exercise by the Federal Government and the Provincial Governments of the borrowing powers given by the Constitution; and
(h) any other matter relating to finance referred by the President.

Answer-2

Federal Consolidated Fund

All revenues received/loans raised by the Federal Government and amount received in repayment of loan, shall be credited to Federal Consolidated Fund.

Expenditures which are charged upon Federal consolidated fund are as under:

(a) the remuneration of President and other expenses of his office, and the remuneration of-

- the Judges of the Supreme Court and the Islamabad High Court;
- the Chief Election Commissioner;
- the Chairman and the Deputy Chairman;
- the Speaker and the Deputy Speaker of the National Assembly;
- the Auditor-General;

(b) The admin expenses, including the remuneration of officers and servants of Supreme Court, the Islamabad High Court, the department of the Auditor-General, the Office of the Chief Election Commissioner and the Secretariats of the Senate and the National Assembly.
(c) Debt charges of the Federal Government, including interest, sinking fund charges, the repayment of capital, and other expenses for raising loans, and redemption of debt on the security of Federal Consolidated Fund;
(d) amount required to satisfy any judgment/order against Pakistan by any court or tribunal; and
(e) any other amount declared by the Constitution or by Act of Majlis-e- Shoora (Parliament).

Answer-3

Formation of National Finance Commission:

The President shall, at intervals not exceeding 5 years, constitute a National Finance Commission.

Members of National Finance Commission:

National Finance Commission shall consist of:

- the Minister of Finance of the Federal Government,
- the Ministers of Finance of the Provincial Governments, and
- such persons as appointed by President after consultation with Governors of the Provinces.

Answer-4

Powers of the Federation to legislate on taxes

Following entries in the Federal legislative list contained in constitution of Pakistan relates to taxes or following are the taxes which can be imposed by the Federation.

43. Duties of customs, including export duties.
44. Duties of excise, including salt, but not including alcoholic liquors, opium or other narcotics;
47. Taxes on income other than agricultural income;
48. Taxes on corporations.
49. Taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed, except sales tax on services.
50. Taxes on the capital value of the assets, not including taxes on immovable property.
51. Taxes on mineral oil, natural gas and minerals for use in generation of nuclear energy.
52. Taxes and duties on the production capacity of any plant, machinery, undertaking
53. Terminal taxes on goods or passengers carried by railway, sea or air; taxes on their fares and freights.

Answer-5

(a)

It shall be the duty of the National Finance Commission to make recommendations to President regarding-

(a) the distribution of tax receipts between the Federation and the Provinces (as in clause (3));
(b) the making of grants-in-aid by the Federal Government to the Provincial Governments;
(c) the exercise by the Federal Government and the Provincial Governments of the borrowing powers given by the Constitution; and
(d) any other matter relating to finance referred by the President.

(b)

The taxes raised under authority of Majlis-e-Shoora (Parliament) are as follows: -

(i) taxes on income, including corporation tax, but not including taxes on income consisting of remuneration paid out of the Federal Consolidated Fund;
(ii) taxes on sales and purchases of goods imported, exported, manufactured or consumed;
(iii) export duties on cotton, and such other export duties as specified by the President;
(iv) such duties as specified by the President; and
(v) such other taxes as specified by the President.

Powers of the Provinces to legislate on taxes

All taxes other than the mentioned in above list of Federal legislative list as contained in the Constitution of Pakistan are covered in the scope of legislation of Provinces. Accordingly, various types of taxes are introduced by the Provinces:

- Agriculture income tax
- Sales tax on services
- Taxes on transfer of immoveable property
- Professional tax
- Tax on luxury houses
- Tax on registration of luxury vehicles etc.
- Property tax

Answer-6

The taxes which can be imposed by the Federation are as follow:

43. Duties of customs, including export duties.
44. Duties of excise, including salt, but not including alcoholic liquors, opium or other narcotics;
47. Taxes on income other than agricultural income;
48. Taxes on corporations.
49. Taxes on the sales and purchases of goods imported, exported, produced, manufactured or consumed, except sales tax on services.

Answer-7

a) It shall be the duty of the National Finance Commission to make recommendations to President regarding-

(a) the distribution of tax receipts between the Federation and the Provinces
(b) the making of grants-in-aid by the Federal Government to the Provincial Governments;
(c) the exercise by the Federal Government and the Provincial Governments of the borrowing powers given by the Constitution; and
(d) any other matter relating to finance referred by the President. **[Article 160(2)]**

b) The taxes (referred to in paragraph (a) of clause (2)) raised under authority of Majlis-e-Shoora (Parliament) are as follows: -

- taxes on income, including corporation tax, but not including taxes on income consisting of remuneration paid out of the Federal Consolidated Fund;
- taxes on sales and purchases of goods imported, exported, manufactured or consumed;
- export duties on cotton, and such other export duties as specified by the President;
- such duties as specified by the President; and
- such other taxes as specified by the President **[Article 160(3)]**

(i) Following entries in the Federal legislative list contained in constitution of Pakistan relates to taxes or following are the taxes which can be imposed by the Federation.

- Duties of customs, including export duties.
- Duties of excise, including salt, but not including alcoholic liquors, opium or other narcotics;
- Taxes on income other than agricultural income;
- Taxes on corporations.

(ii) Following are the taxes which can be imposed by provinces:

- Agriculture income tax;
- Sales tax on services;
- Professional tax;
- Property tax.

Answer-8

Six types of taxes which are covered within the legislative powers of Provinces:

(i) Sales tax on services
(ii) Taxes on transfer of immoveable property
(iii) Professional tax
(iv) Tax on luxury houses
(v) Tax on registration of luxury vehicles etc.
(vi) Property tax

ETHICS

3

CHAPTER 3
ETHICS

Ethics – meaning and application

Ethics means characters and customs. Aristotle was the first one to study ethics. He believed that ethical behavior is knowledge that actions are done for betterment of common good. To determine what is ethically good for the individual and society, Aristotle said it is necessary to possess **3 virtues** of practical wisdom:

1. temperance,
2. courage, and
3. justice.

1. ETHICS FOR TAX LEGISLATORS

"Legislative office is a public trust, and every effort for personal gain through official conduct is a violation of that trust"

The constitution requires the legislature:

- to make a code of ethics prohibiting conflicts between the public duty and private interests of members of the legislature.
- to enact a code of ethics for all officials and employees of the state and its political subdivisions.

Canons of taxation

Canons of taxation are the basic principles to run a good tax system. Adam Smith was the first economist to develop a list of canons of taxation. Later on, some new canons were added. These canons help tax legislators in constituting a good tax system. The canons of taxation are discussed below:

Original and Main Canons of Taxation discussed by Adam Smith in famous books "The Wealth of Nations"

1. Canon of Equity
   This principal says that a person who earns more should pay more to the Government as compared to a person who earns less. As a result the person earning high income should pay tax at higher rate as compared to a person who is earning less income.
   It is one of the fundamental concepts to bring social equality and equal distribution of wealth in a country.
2. Canon of Certainty
   The tax that a person is going to pay should be certain. Everything should be made clear and simple for the taxpayer. It ensures that the taxpayer should have full knowledge about amount of tax payment, mode of payment and the due-date. If this canon does not exist, it leads to tax evasion.
   Another aspect of certainty is that the Government is also certain regarding the amount it will collect from tax.
3. Canon of Convenience
   The procedure for tax payment should be easy, convenient and taxpayer-friendly. The time and manner of payment must be convenient for the tax payer so that he is able to pay his taxes in due time. If the time and manner of the payment is not convenient, then it may lead to tax evasion and corruption.
4. Canon of Economy
   The canon of economy states that the cost of collecting taxes should be as minimum as possible. The cost of tax collection should be lower than amount of tax received by Government.
   The purpose of collecting taxes is to generate revenue for the Government. If the canon of economy isn't applied, the collected amount will not be sufficient for Government.

Additional Canons of Taxation

Functions of the government increased significantly since Adam Smith's time. Accordingly, modern economists gave following additional canons of taxation.

5. Canon of Productivity
   It says that there should be fewer taxes with large revenues, rather than more taxes with lesser amounts of revenue. It is better to impose only those taxes that are able to produce larger returns. More taxes tend to create panic and confusion among the taxpayers.
6. Canon of Elasticity
   Taxes imposed should be elastic i.e., they can be increased or decreased, according to the demands of the Government. If the tax is elastic in nature, Government can easily increase its revenue by increasing the rate of tax. An example of such tax can be the income tax, which is considered very much ideal in accordance with the canon of elasticity.

7. Canon of Flexibility
   Flexibility is different from elasticity. A flexible tax quickly adjusts to the new conditions. If the tax system is not flexible, new areas will remain un-taxed.
8. Canon of Simplicity
   The system of taxation should be simple. The entire process should be non-technical and straightforward. If it is difficult and complicated to understand, then it will lead to corruption.
9. Canon of Diversity
   It says that the Government should collect tax from different sources rather than relying on a single source. If Government relies on a single tax source it can be harmful for the economy. Therefore Government introduces both direct and indirect taxes.

2. ETHICS FOR TAXPAYERS

Morality behind Tax Compliance

There are three approaches to ethics for tax compliance which are as under:

- **Utilitarianism** tells us to aim for greatest happiness across the population. 'Happiness' is the satisfaction of our desires.
- **Deontology** bases ethics on the idea of duty.
- **Virtue ethics** focus on the virtues we should have. A broad conception must be used here. Virtue is not only honesty but using one's talents and leading a fulfilled life is also a virtue.

Ethics and morality for tax payers regarding taxation compliance

- For Taxpayers following **utilitarian approach**, the important economic goal is to ensure that goods and services are available to everyone for decent life. Utilitarian compliance level will be better because there is a great need of resources for general public and country.
- **Deontologist** approach lay down absolute duties. There is a duty of individuals to pay for social resources provided by Government. The one who uses a public hospital or a public road, should pay for it. So this approach says that it is obligation of taxpayer to pay tax for use of public facilities.
- **Virtue ethics** says one should use one's talents to the full. Financial incentives encourage people to use their talents but very high tax rates reduce those incentives. Another virtue is charity either in form of cash or time. The more take-home cash people have, the more charities they can afford; and also find time to perform charity work. A third virtue is independence. It is good to live on own money. Lower tax rate make independence easy.
- Tax can be used for all purposes, and it is clear that what ethicists would say about these purposes.

Purpose	Utilitarian	Deontology	Virtue Ethics
Providing law and order, health care and education service to public	Will approve tax because more goods and services will be available resulting in increase in happiness among people.		Will approve tax because this will enable people to lead prosperous lives and utilize their talents to full.
Helping the needy and poor with tax money	Will approve tax because it will lead to equal distribution of wealth and happiness among society.	Will approve because it is our duty to take care of the poor.	Will approve tax because taking care of less fortunate is itself a virtue

- Morality for citizens to pay taxes is justified so that:
  - State is able to provide proper infrastructure,
  - State is able to provide level playing field to all.

Tax avoidance and evasion

Most people pay their taxes but not all are willing. So lastly, let's look at whether other forms of behaviour can be ethically acceptable:

- Tax avoidance is the legal use of the tax law to one's own advantage, to reduce the amount of tax payable. For example, it is upto tax payer that whether the business is started as a partnership or company. In case of partnership tax rates is lower than that of company. Another example is starting business in a tax-free zone.
- Tax evasion is an illegal practice where individuals, AOPs and companies unlawfully avoids payment of tax. In tax evasion taxpayer intentionally conceals the true state of affairs to tax authorities. It is punishable under the law. For example, concealment of income, misclassifying income under another head, claiming excess deductions, and claiming wrong tax credits.

Situation	Strategy adopted
Mr. A is in the business of selling shoes. His sales are Rs. 20 M. He kept all cash in his bank locker to hide it from tax authorities.	It is tax evasion and a Criminal Act. He cannot buy any asset form this money unless he declares this income and pays tax on it
Mr. B earned income of Rs 50 M. However, he declared only that income which is verifiable from the banks i.e. 36M. Remaining amount has been hidden in a separate bank account.	This is also a tax evasion. Understatement is also an offence.
Mr. C earned Rs 50 M. However, he recorded 37 M expenses using legal tactics to reduce his income.	Tax avoidance, which is legally permissible.

A utilitarian, concerned with aggregate welfare, might be willing for tax avoidance. If tax is avoided, wealth is kept in the private sector (means it will not go to Government). The utilitarian says that charging tax will put more burden on middle class who cannot afford hiring tax lawyers. The dissatisfaction of middle class will be more as compared to the satisfaction achieved by rich class.

A virtue ethicist would dislike tax avoidance. It is not ethical to exploit rules knowing that one is exploiting it for oneself.

A deontologist will not favor tax avoidance, but might not condemn it either. Deontologists can easily argue for a duty to obey the law.

3. ETHICS FOR TAX ADMINISTRATORS/ TAX IMPLEMENTING AUTHORITIES

Ethics for tax administrators - Introduction

The tax administration is not responsible for tax policy and tax legislation but deals with current tax system. Federal Board is the main administrative authority under the law to monitor various types of taxes.

During administration, FBR itself or through its staff exercises the following powers:

- Power to collect revenue
- Power to change the method of accounting
- Power to make assessment of tax and
- Power to attach bank accounts
- Power to seize property

The authorities can misuse the above mentioned powers which can result in following against taxpayer:

- Loss of property and income
- Imprisonment

So above powers if wrongly used can result in loss of fundamental human rights. So there is need for ethics so that tax authorities can use the powers fairly and with transparency and morality.

Illustration-1
Mr. Zahid is running a textile unit and tax amounting to Rs. 5M is assessed against him. His bank accounts balance is Rs. 10M. However, he has to fulfil his exports orders. In case he fails to fulfil his orders, he would lose his customers and that orders. Considering his present critical financial position, Zahid believes that tax recovery proceedings by recovery from bank account (Attachment of bank account) would cause an irreparable loss. So he files a request to FBR for allowing him to pay the tax dues in instalments.
FBR staff has the power to allow him relief or recover this tax directly from his bank account. Justice and equity demands that his request should be entertained so that his continuation and prosperity of business would eventually result in payment of better taxes in future.

Illustration-2
Income Tax Ordinance, sales tax law, Federal excise law empower tax authorities to select cases for audit. This power can be misused by selecting some cases while leaving many unaudited.

[Source: ICAP study Text]

Pillars of tax administration

For the benefit of taxpayer and keep check on the misuse of powers by tax authorities, following are the pillars of tax administration:

Fairness
Tax authorities should try to be fair, neutral and impartial while administering the law. There should be no discrimination on the basis of race, sect etc.

Transparency
All Proceedings must be transparent and must be seen as transparent.

Accountability
There must be a strong system of accountability for wrong doers which should stop corruption, nepotism and maladministration.

Equity
Similarly situated taxpayers should be taxed in same way by tax authorities. Due care should be exercised to ensure that salaried class is not taxed more than business class. Administrators should not achieve their objectives in an irrational way.

Under 4 pillars, following are the ethical issues which are faced by tax administrating authorities:

1. Corruption
2. Confidentiality/Secrecy
3. Conflict of interest
4. Inconsistency in application of law
5. Lack of autonomy
6. Political influence
7. Acceptance of gifts
8. Discretion

To avoid pitfalls of abusive use of discretion, 7 principles for structuring discretion are as follows:

1. Open plans
2. Open policy statements
3. Open rules
4. Open findings
5. Open reasons
6. Open precedents
7. Fair informal procedure

Responsibilities of tax implementing authorities

Tax Administrators shall:

1. Try to be impartial, fair, neutral and consistent in administration of law ignoring the race or economic circumstances.
2. Provide efficient and quality service to all stakeholders in an effort to exceed their expectation.
3. Follow the law completely and no exemptions or credit should be provided to the person who is not eligible for it.
4. Take all measures to collect tax on timely basis in the interest of the Government and at lowest cost.
5. Make the payment of refunds on timely basis.
6. Show the honesty and integrity to gain confidence of the government and taxpayers;
7. Avoid participation in political activity.
8. Educate taxpayers about their rights and obligations so that tax payers voluntarily comply with the requirements of law.
9. Keep the confidentiality of the information provided by the taxpayer with highest level of security.
10. Refrain from receiving gifts from actions and non-actions.

4. ETHICS FOR TAX PRACTITIONERS

Following are the 5 fundamental principles of ethics for tax practitioners:

1. Integrity

The tax practitioner should be straightforward and honest in all professional and business relations. He must act honestly and with integrity. All tax laws should be followed properly. He should not misuse the money given by his client for payment of tax.

2. Objectivity

Practitioner should not allow bias, conflicts of interest or undue influence of others to override their professional or business judgments.

3. Confidentiality

The tax practitioner should keep all information confidential acquired in professional and business relationships. The information received from client should not be disclosed to anyone unless it is required by law. Further the information obtained from client should also not be used for personal benefit or for benefit of a third party.

4. Professional Competence and due care

Tax practitioner has a duty to maintain professional knowledge and skill at such level that client receives a competent service. The practitioner should have complete knowledge and skill of the service provided by him. All tax laws should be applied properly in accordance with the circumstances. Staff members must also be well trained.

5. Professional Behavior

The practitioner should follow the laws and regulations and should avoid actions which discredits the profession. He should follow the code of ethics developed for tax practitioner. He should behave with courtesy with people.

5. CODE OF ETHICS FOR CHARTERED ACCOUNTANTS AS APPLICABLE TO TAX SERVICES

Tax Services
Tax services include preparing tax return, making tax calculations for accounting entries, suggesting tax planning etc.

Providing tax services to an audit client might create a self-review or advocacy threat.
Code of Ethics includes requirements that prohibit firms (and network firms) from providing **certain** tax services to audit clients in some circumstances because the threats cannot be addressed by applying safeguards.

Tax Services to Audit clients
Factors for evaluating level of threats created by providing tax service to an audit client include:

- The characteristics of the engagement.
- The tax expertise of client's employees.
- The system by which tax authorities assess and administer the tax and the role of the firm (or network firm) in that process.
- The complexity of tax regime (and degree of judgment necessary in applying it).

1) Tax return preparation
All Audit Clients
Providing tax return preparation services (to audit client) does not usually create a threat. Tax return preparation services involve:

- Assisting clients with tax reporting obligations by compiling information, including payment of tax.
- Advising on tax treatment of past transactions and responding on behalf of audit client to tax authorities' requests for additional information and analysis (for example, providing explanations for approach being taken).

Tax return preparation services are usually based on historical information and principally involve presentation of such information under existing tax law. Further returns are also reviewed by tax authorities.

2) Tax Calculations for the Purpose of Preparing Accounting Entries
a) All Audit Clients
Preparing calculations of current and deferred tax liabilities (or assets) for an audit client for accounting entries that will be later on audited by the firm creates a self-review threat.
In addition to the factors discussed above (4 bullets), a factor relevant for evaluating threat is that calculation might have a material effect on the financial statements on which the firm will express an opinion.
b) Audit Clients that are Not Public Interest Entities
Safeguards to address self-review threat when the audit client is not a public interest entity include:

- Using professionals who are not audit team members to perform the tax service.
- Having an appropriate reviewer who was not involved in:
  - the service review
  - the audit work or
  - service performed.

c) Audit Clients that are Public Interest Entities
A firm (or a network firm) shall not prepare tax calculations of current and deferred tax liabilities (or assets) for an audit client (public interest entity) for preparing accounting entries that are material to the financial statements on which the firm will express an opinion.
If impact of accounting entries on financial statements is immaterial then above safeguards mentioned in point (b) will be applied.

Example-1

A Pakistani audit firm is faced with the following situations:

Situation 1

ABC limited an audit client has requested your firm to prepare current and deferred tax working for the purpose of preparing accounting entries that will be reviewed by your firm at the time of Audit. ABC Ltd is not a public interest entity.

Situation 2

ABC limited an audit client has requested your firm to prepare current and deferred tax working for the purpose of preparing accounting entries that will be reviewed by your firm at the time of Audit. ABC Ltd is a public interest entity.

Required:

With reference to the ICAP Code of Ethics, what are the threats presented by the events described above. Also comment upon the safeguards to be taken to reduce the said threat (if any)

[ICAP study Text]

Answer

Situation 1

Preparing calculations of current and deferred tax liabilities (or assets) for an audit client for preparing accounting entries that will be subsequently audited by the firm creates a self-review threat. The significance of the threat will depend on:

- The complexity of tax regime (and degree of judgment necessary in applying it)
- The tax expertise of client's employees
- The materiality of the amounts to the financial statements.

Safeguards

Safeguards to be applied to eliminate/reduce threat:

- Using professionals who are not audit team members to perform the tax service.
- Obtaining advice from an external tax professional
- Having an appropriate reviewer who was not involved in:
  - the service review
  - the audit work or
  - service performed.

Situation 2

Except in emergency situations, a firm (or a network firm) shall not prepare tax calculations of current and deferred tax liabilities (or assets) for an audit client (public interest entity) for preparing accounting entries that are material to the financial statements on which the firm will express an opinion.

In emergency or other unusual situations when it is impractical for the audit client to make other arrangements we may provide tax service. This may be the case when:

- only the firm has the resources and knowledge of the client's business to assist client in timely preparation of its calculations of current and deferred tax liabilities (or assets), and
- stopping firm from providing service will result in significant difficulties for the client (for example, failure to meet regulatory reporting requirements).

Safeguards

- Those who provide the services are not members of the audit team;
- The services are provided for only a short period of time and are not expected to recur; and
- The situation is discussed with those charged with governance.

Example-2

Bilal Azhar, ACA is Manager Taxation at a large tax consultancy firm and reports to Bader Ali, FCA who is one of the partners of the firm.

Bilal Azhar is presently engaged in the preparation of the income tax return of Digital Systems Limited (DSL), an IT company. During the review of the tax workings, he discovers that DSL has charged certain expenses against which no supporting documents are available. He brings this matter to the attention of Bader Ali who has responded him that since this is not an audit engagement, it is not our responsibility to highlight such matters.

Required:

Briefly discuss how Bader Ali may be in breach of the fundamental principles of ICAP's Code of Ethics. Also, state the potential threats that Bilal Azhar may face in the above circumstances and how he should respond.

[ICAP study Text]

Answer

Fundamental principles breached:

In the given situation, Bader may be in breach of the following fundamental principles of Code of Ethics for Chartered Accountants:

Professional behaviour

The practitioner should follow the laws and regulations and should avoid actions which discredits the profession.

Bader has breached the fundamental principle of professional behavior as his proposed suggestion in respect of ignoring the appropriate adjustments to the income tax return would affect the good reputation of the profession.

Integrity

The tax practitioner should be straightforward and honest in all professional and business relations.

Bader has breached the fundamental principle of integrity as he has knowingly ignored the required adjustments to be made in the income tax return.

Potential threat:

Intimidation threat

Bilal may face intimidation threat from Bader as refusal to obey instruction may risk his job.

Safeguards:

Identified threats are significant as Bilal is being instructed from the highest level of management. In order to reduce the threat to an acceptable level, one or more of the following safeguards should be applied:

- Discuss the matter with Bader and persuade him to follow code of ethics/contact the tax client to make necessary adjustments.
- Consider informing appropriate authorities like a senior partner in the firm.
- Refuse to implement the given proposals.
- Seek legal advice.
- In case threat could not be reduced consider resigning from the job

ICAP PAST PAPER QUESTIONS

Question-1
Briefly explain the ethical responsibilities of the tax implementing authorities. (10)
(Q.8 September 2014)

Question-2
Briefly describe any three main canons of taxation which can be helpful in formulating a good tax system. (03)
(Q.7 September 2015)

Question -3
List any six ethical issues which may be faced by tax administration authorities while discharging their duties under the four pillars of tax administration. (03)
(Q.7(c) March 2016)

Question-4
List any seven responsibilities of tax administrators emanating from best ethical practices. (07)
(Q.7 (a) September 2016)

Question-5
(a) Briefly describe the pillars/principles of tax administration which are meant to safeguard the interest of taxpayers and avoid abuse of powers by the tax administrators. (04)
(b) List any **six** ethical issues that which administrators may face while discharging their duties. (03)
(Q.8 (a) and (c) September 2017)

Question-6
a) List any seven responsibilities of tax administrators arising from best ethical practices. (07)
b) State any six ethical issues which the administrators may face while discharging their duties. (03)
(Q.8 March 2020)

Question-7
(a) Identify any **four** powers of the Federal Board of Revenue (FBR) with respect to collection of tax. What consequences may be faced by taxpayer if such powers are misused by any officer(s) of FBR? (03)
(b) Briefly explain any **two** pillars of tax administration which may be helpful in safeguarding the interest of taxpayers and avoiding the abuse of powers by the tax administration. (02)
(c) List any **six** ethical issues which may be faced by tax administration authorities while discharging their duties under the four pillars of tax administration. (03)
(Q.8 Sep. 2020)

ICAP PAST PAPER SOLUTIONS

Answer-1

Responsibilities of tax implementing authorities

Tax Administrators shall:

1. Try to be impartial, fair, neutral and consistent in administration of law ignoring the race or economic circumstances.
2. Provide efficient and quality service to all stakeholders in an effort to exceed their expectation.
3. Follow the law completely and no exemptions or credit should be provided to the person who is not eligible for it.
4. Take all measures to collect tax on timely basis in the interest of the Government and at lowest cost.
5. Make the payment of refunds on timely basis.
6. Show the honesty and integrity to gain confidence of the government and taxpayers;
7. Avoid participation in political activity.
8. Educate taxpayers about their rights and obligations so that tax payers voluntarily comply with the requirements of law.
9. Keep the confidentiality of the information provided by the taxpayer with highest level of security.
10. Refrain from receiving gifts from actions and non-actions.

Answer-2

The three canons of taxation are discussed below:

1. Canon of Equity

This principal says that a person who earns more should pay more to the Government as compared to a person who earns less. As a result the person earning high income should pay tax at higher rate as compared to a person who is earning less income.

It is one of the fundamental concepts to bring social equality and equal distribution of wealth in a country.

2. Canon of Certainty

The tax that a person is going to pay should be certain. Everything should be made clear and simple for the taxpayer. It ensures that the taxpayer should have full knowledge about amount of tax payment, mode of payment and the due-date. It this canon does not exist, it leads to tax evasion.

Another aspect of certainty is that the Government is also certain regarding the amount it will collect from tax.

3. Canon of Convenience

The procedure for tax payment should be easy, convenient and taxpayer-friendly. The time and manner of payment must be convenient for the tax payer so that he is able to pay his taxes in due time. If the time and manner of the payment is not convenient, then it may lead to tax evasion and corruption.

Answer-3

Following are the ethical issues which are faced by tax administrating authorities under four pillars:

1. Corruption
2. Confidentiality/Secrecy
3. Conflict of interest
4. Inconsistency in application of law
5. Lack of autonomy
6. Political influence
7. Acceptance of gifts
8. Discretion

Answer-4

Same as Answer-1

Answer-5

(a) **Pillars of tax administration**

For the benefit of taxpayer and keep check on the misuse of powers by tax authorities, following are the pillars of tax administration:

Fairness

Tax authorities should try to be fair, neutral and impartial while administering the law. There should be no discrimination on the basis of race, sect etc.

Transparency

All Proceedings must be transparent and must be seen as transparent.

Accountability

There must be a strong system of accountability for wrong doers which should stop corruption, nepotism and maladministration.

Equity

Similarly situated taxpayers should be taxed in same way by tax authorities. Due care should be exercised to ensure that salaried class is not taxed more than business class. Administrators should not achieve their objectives in an irrational way.

(b) Same as Answer-3

Answer-6

a) Same as Answer-4
b) Same as Answer-3

Answer-7

a. During administration, FBR itself or through its staff exercises the following powers:

- Power to collect revenue
- Power to change the method of accounting
- Power to make assessment of tax and
- Power to attach bank accounts
- Power to seize property

The authorities can misuse the above mentioned powers which can result in following against taxpayer:

- Loss of property and income
- Imprisonment

b. For the benefit of taxpayer and keep check on the misuse of powers by tax authorities, following are the pillars of tax administration:

Fairness

Tax authorities should try to be fair, neutral and impartial while administering the law. There should be no discrimination on the basis of race, sect etc.

Transparency

All Proceedings must be transparent and must be seen as transparent.

c. Same as Answer-3.

BASIC CONCEPTS OF INCOME TAX

4

1. Tax year [Sec. 74]
2. Resident and non-resident persons [Sec. 81]
3. Resident individual [Sec. 82]
4. Income Tax Rules 2002-Rule 14
5. Resident company [Sec. 83]
6. Resident association of persons [Sec. 84]
7. Person [2(42), Sec. 80]
8. Company" [2(12) and Sec. 80]
9. Trust [80(2)(d)]
10. Unit trust [2(14)] and [80(2)(e)]
11. Rate of Tax for Companies
12. Small Company [2(59A)]
13. Association of Persons [2(6) & Sec. 80]
14. Firm [Sec. 80(2)(c)]
15. Member Sec 2(32)
16. Tax on taxable income [Sec. 4]
17. Taxable income [Sec. 9]
18. Total Income [Sec. 10]
19. Heads of income [Sec. 11]
20. Zakat. [Sec.60]
21. Workers' Welfare Fund [Sec.60A]
22. Workers' Participation Fund [Sec.60B]
23. Principle of taxation of individuals [Sec. 86]
24. Deceased individuals [Sec. 87]
25. Authors [Sec. 89]
26. Income of minor child [Sec 91]
27. Income of joint owners [Sec 66]
28. Apportionment of deductions [Sec 67]
29. Fair market value [Sec 68]
30. Receipt of income [Sec 69]
31. Recouped expenditure [Sec 70]
32. Currency conversion [Sec 71]
33. Cessation of source of income [Sec 72]
34. Rules to prevent double derivation and double deductions [Sec 73]
35. Tax on dividends [Sec. 5]
36. General provisions relating to taxes imposed under sections 5 and 6 [Sec. 8]

Lecture #1

CHAPTER 4
BASIC CONCEPTS OF INCOME TAX

Tax year [Sec. 74]

(1) Normal tax year اس کے بعد

The tax year shall be a period of 12 months ending on June 30th (hereinafter referred to as 'normal tax year') and shall be denoted by the calendar year in which 30th June falls. 30.6.2022 → 2022

Calendar year is a year which ends on December 31. X

(2) Special tax year اجازت

Where a person is allowed, to use a 12 months' period different from normal tax year, such period shall be that person's tax year (hereinafter referred to as **'special tax year'**) and shall, be denoted by the calendar year relevant to normal tax year in which the closing date of the special tax year falls.

Persons	Accounting year	Type of Tax year	Tax year
Honda Atlas Cars	April 1, 2009 – March 31, 2010	Special	TY 2010
Mr. Ahsan	July 1, 2010 – June 30, 2011	Normal	TY 2011
GEF Firm	January 1, 2010 – December 31, 2010	Special	TY2011
ABC Company	October 1, 2009 – September 30, 2010	Special	TY 2011

(2A) The Board,- کل والا تان

Move FBR

(i) in the case of a class of persons having a special tax year may permit, through official Gazette, to use a normal tax year; and سادہ تان

(ii) in the case of a class of persons having a normal tax year may permit, through official Gazette, to use a special tax year.

Class of person	Special tax year
Companies manufacturing sugar	1st October to 30th September
All insurance and banking companies	1st January to 31st December

(3) N to S — A person may apply, in writing, to the Commissioner to allow him to use a 12 months' period, other than normal tax year, as special tax year and the Commissioner may allow him. The order will be passed by the Commissioner if the condition mentioned below (in sub-section (5)) is fulfilled. → change in TY (Normal to Special)

(4) S to N — A person using a special tax year, may apply in writing, to the Commissioner to allow him to use normal tax year and the Commissioner may allow him. The order will be passed by the Commissioner if the condition mentioned below (in sub-section (5)) is fulfilled.

(5) Condition — The Commissioner shall grant the permission to change the tax year: اور بھی دے سکتا conditions

- from normal to special or
- special to normal اشد ضرورت

only if the person has shown a compelling need. The Commissioner may impose conditions while giving permission. e.g (Permission is only for 3 year)

(6) An order by Commissioner of change in tax year shall be passed after providing to the applicant an opportunity of being heard. If the application is rejected the Commissioner shall mention in order the reasons for rejection. → hearing Tax Payer کی بات لازمی سنی جائے گی Tax Payer

(7) The Commissioner may by order, after providing an opportunity of being heard, withdraw the permission granted regarding change in tax year.

(8) Effective Date — An order of change in tax year [under sub-section (3) or (4)] shall take effect from 1st day of the special tax year or the normal tax year.

(9) Transitional tax year

Where the tax year of person changes, the period between:

- the end of the last tax year prior to change and
- the date on which the changed tax year commences

shall be treated as a separate tax year, to be known as the "transitional tax year".

(11) A person dissatisfied with any order of Commissioner (under sub-section (3), (4) or (7)) may file a review application to the Board. The decision by the Board shall be final.

Example
Mr. A is using normal tax year. He has obtained permission from the Commissioner to use a special tax year which will end on 31st November each year. His recent normal tax year has just ended on June 30th 2010. You are required to show his normal tax year, transitional tax year and special tax year.

Year	Normal tax year	Transitional tax year	Special tax year
Starting from	1st July 2009	1st July 2010	1st December 2010
Ending on	30th June 2010	31st November 2010	31st November 2011
Tax Year	TY 2010	Normal tax year related to 31st November 2010 is 2011. So transitional tax year is 2011	Normal tax year related to 31st November 2011 is 20 12. So Special tax year is 2012

Resident and non-resident persons [Sec. 81]

(1) A person shall be a resident person for a tax year if the person is –
- (a) a resident individual, resident company or resident association of persons for the year; or
- (b) the Federal Government.

(2) A person shall be a non-resident person for a tax year if the person is not a resident person for that year.

EXPLANATION:
Q. Why establishing the residential status of persons is important?
Ans. This is important in order to determine the scope of taxable income for :
- ➢ **Resident persons** Both Pakistan source income and foreign source income are taxable
- ➢ **Non-resident persons** Only Pakistan source income is taxable

Resident individual [Sec. 82]
An individual shall be a resident individual for a tax year if the individual –
- (a) is present in Pakistan for a period of, or periods amounting in aggregate to, 183 days or more in the tax year;
- (c) is an employee or official of the Federal Government or a Provincial Government posted abroad in the tax year.

Citizenship is not relevant for determining residential status.

Income Tax Rules 2002-Rule 14
- a) A part of a day that an individual is present in Pakistan (including the day of arrival in, and the day of departure from, Pakistan) counts as a whole day of such presence;
- b) The following days in which an individual is wholly or partly present in Pakistan count as a whole day of such presence, namely:-
  - a public holiday;
  - a day of leave, including sick leave;
  - a day that the individual's activity in Pakistan is interrupted because of a strike, lock-out or delay in receipt of supplies; or Purchases
  - a holiday spent by the individual in Pakistan before, during or after any activity in Pakistan; and
- c) a day or part of a day where an individual is in Pakistan solely by reason of being in transit between two different places outside Pakistan does not count as a day present in Pakistan.

exception
→ example → [China → Pak 8h → Afg] Lekin Pak ruka 8h Q k direct flight Afg nahi jati) (stay in Pak 8h count nahi hongy)

Resident company [Sec. 83]
A company shall be a resident company for a tax year if –
- (a) it is incorporated or formed by or under any law in force in Pakistan;
- (b) the control and management of the affairs of the company is situated wholly in Pakistan at any time in the year; or
- (c) it is a Provincial Government or Local Government in Pakistan.

Resident association of persons [Sec. 84]
An association of persons shall be a resident association of persons for a tax year if the control and management of the affairs of the association is situated wholly or partly in Pakistan at any time in the year.

Person [2(42), Sec. 80]

The following shall be treated as persons under Income Tax Ordinance, 2001, namely:

(a) An individual;
(b) A Company or an association of persons incorporated, formed or established in Pakistan or elsewhere;
(c) The Federal Government, a foreign government, a political sub division of a foreign government, or public international organization.

"Company" [2(12) and Sec. 80]

"Company" means the following:

(a) a company as defined in the Companies Act, 2017.
(b) a body corporate formed by or under any law in force in Pakistan;
(c) A Modaraba
(d) a body incorporated under the law of a country outside Pakistan relating to incorporation of companies;
(e) a co-operative society, a finance society or any other society;
(f) a non-profit organization
(g) a trust, an entity or a body of persons established by or under any law for the time being in force;
(h) a foreign association, whether incorporated or not, which the Board has declared to be a company for the purposes of ITO 2001;
(i) a Provincial Government;
(j) a Local Government in Pakistan; or
(k) a Small Company;

Trust [80(2)(d)]

Trust means an obligation attached to the ownership of property and arising out of the confidence given to and accepted by the owner, for the benefit of another, or of another and the owner, and includes a unit trust.

Unit trust [2(14)] and [80(2)(e)]

Unit trust means any trust under which beneficial interests are divided into units so that the rights of the beneficiaries to income/capital are determined by the number of units held.

Rate of Tax for Companies

(i) The rate of tax on the taxable income of a company shall be as defined in the following table:

Tax Year	Rate
2022	29%

(ii) where the taxpayer is a small company the rate of tax on the taxable income of a company shall be as defined in the following table:

Tax Year	Rate
2022	21%
2023 and onwards	20%

Small Company [2(59AB)]

"Small Company" means a company registered on or after the 1st day of July, 2005, under the Companies Act, 2017, which,-

(i) has paid up capital plus undistributed reserves not exceeding 50 million rupees;
(ii) has employees not exceeding 250 any time during the year
(iii) has annual turnover not exceeding 250 million rupees; and

Turnover means sales.

(iv) is not formed by the splitting up or the reconstitution of business already in existence; and
(v) is not a small and medium enterprise.

Association of Persons [2(6) & Sec. 80]

"Association of persons" includes the following

(a) A firm
(b) A Hindu Undivided Family
(c) Any Artificial Juridical Person
(d) Any body of persons formed under a foreign law. However a company is not included in association of person.

Firm [Sec. 80(2)(c)]
Firm means the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

"Member" Sec 2(32)
in relation to an association of persons, includes a partner in a firm;

Tax on taxable income [Sec. 4]

(1) Income tax shall be
   (a) imposed for each tax year,
   (b) charged at the rates specified in 1st Schedule,
   (c) charged on every person who has taxable income for the year.

(2) The income tax for a tax year shall be computed
   (a) by applying the rate of tax to the taxpayer's taxable income for the year, and
   (b) tax credits shall be subtracted from above figure.

Salary income	xxx
Business income	xxx
Income from property	xxx
Income from capital gains	xxx
Income from other sources	xxx
Total Income	xxx
Less: Zakat and other deductible allowances	(xxx)
Taxable income	xxx
Tax liability (Taxable income as calculated above x Rate of tax)	xxx
Less: Tax credits	(xxx)
Income tax payable to Government	xxx

(3) Order of Applying tax credits
Where a taxpayer is allowed more than one tax credit for a tax year, credits shall be applied in following order:
   (a) foreign tax credit (allowed under section 103); then
   (b) tax credit allowed on charitable donations, tax credit for investment in shares and insurance, tax credit on contribution to approved pension fund (u/s 61-63); and then
   (c) tax credit for quarterly advance tax paid (u/s 147) or tax deducted.

THE FIRST SCHEDULE

Division I

Rates of Tax for Individuals and Association of Persons

(1) Subject to clause (2), the rates of tax imposed on income of every individual and association of persons except a salaried individual shall be as set out in the following Table, namely:—

TABLE

S. No	Taxable Income	Rate of Tax
1.	Where taxable income does not exceed Rs. 400,000	0%
2.	Where taxable income exceeds Rs. 400,000 but does not exceed Rs. 600,000	5% of the amount exceeding Rs. 400,000
3.	Where taxable income exceeds Rs. 600,000 but does not exceed Rs. 1,200,000	Rs. 10,000 plus 10% of the amount exceeding Rs. 600,000
4.	Where taxable Income exceeds Rs. 1,200,000 but does not exceed Rs. 2,400,000	Rs. 70,000 plus 15% of the amount exceeding Rs. 1,200,000
5	Where taxable Income exceeds Rs. 2,400,000 but does not exceed Rs. 3,000,000	Rs. 250,000 plus 20% of the amount exceeding Rs. 2,400,000
6	Where taxable Income exceeds Rs. 3,000,000 but does not exceed Rs. 4,000,000	Rs. 370,000 plus 25% of the amount exceeding Rs. 3,000,000
7.	Where taxable Income exceeds Rs. 4,000,000 but does not exceed Rs. 6,000,000	Rs. 620,000 plus 30% of the amount exceeding Rs. 4,000,000
8.	Where taxable Income exceeds Rs. 6,000,000	Rs. 1,220,000 plus 35% of the amount exceeding Rs. 6,000,000

(2) Where the income of an individual chargeable under the head "'salary" exceeds seventy-five per cent of his taxable income, the rates of tax to be applied shall be as set out in the following Table, namely:—

S. No	Taxable Income	Rate of Tax
(1)	(2)	(3)
1.	Where taxable income does not exceed Rs. 600,000	0%
2.	Where taxable income exceeds Rs. 600,000 but does not exceed Rs. 1,200,000	5% of the amount exceeding Rs. 600,000
3.	Where taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 1,800,000	Rs. 30,000 plus 10% of the amount exceeding Rs. 1,200,000
4.	Where taxable income exceeds Rs. 1,800,000 but does not exceed Rs. 2,500,000	Rs. 90,000 plus 15% of the amount exceeding Rs. 1,800,000
5.	Where taxable income exceeds Rs. 2,500,000 but does not exceed Rs. 3,500,000	Rs. 195,000 plus 17.5% of the amount exceeding Rs. 2,500,000
6.	Where taxable income exceeds Rs. 3,500,000 but does not exceed Rs. 5,000,000	Rs. 370,000 plus 20% of the amount exceeding Rs. 3,500,000
7.	Where taxable income exceeds Rs. 5,000,000 but does not exceed Rs. 8,000,000	Rs. 670,000 plus 22.5% of the amount exceeding Rs. 5,000,000
8.	Where taxable income exceeds Rs. 8,000,000 but does not exceed Rs. 12,000,000	Rs. 1,345,000 plus 25% of the amount exceeding Rs. 8,000,000
9.	Where taxable income exceeds Rs. 12,000,000 but does not exceed Rs.30,000,000	Rs. 2,345,000 plus 27.5% of the Amount exceeding Rs. 12,000,000
10.	Where taxable income exceeds Rs. 30,000,000 but does not exceed Rs.50,000,000	Rs. 7,295,000 plus 30% of the amount exceeding Rs. 30,000,000
11.	Where taxable income exceeds Rs. 50,000,000 but does not exceed Rs.75,000,000	Rs. 13,295,000 plus 32.5% of the amount exceeding Rs. 50,000,000
12.	Where taxable income exceeds Rs.75,000,000	Rs. 21,420,000 plus 35% of the amount exceeding Rs. 75,000,000

Salaried Person

An individual whose income from salary exceeds 75% of taxable income in a tax year will be considered as a salaried person.

Taxable income [Sec. 9]
The taxable income of a person for a tax year shall be the total income (under clause (a) of section 10) for the year reduced (but not below zero) by the total of any "deductible allowances" of the person for the year.

Question	Rs.
Mr. Umer has disclosed the following data for TY 2019:	
Salary Income	250,000
Business Income	150,000
Zakat paid under Zakat and Ushr Ordinance	470,000
Calculate his taxable income?	
Answer	
Salary Income	250,000
Business Income	150,000
Total income	400,000
Less: Zakat	(470,000)
Taxable Income	-
Nothing will be carried forward. Refer [S.60 (3)]	

Total Income [Sec. 10]
The total income is sum of -
(a) Person's income under all heads of income for the year; and
(b) Person's income exempt from tax under any of the provisions of this Ordinance.

Heads of income [Sec. 11]
(1) For imposing tax and calculating total income, all income shall be classified under the following heads:
  a) Salary;
  b) Income from property
  c) Income from Business;
  d) Capital Gains; and
  e) Income from Other Sources.
(2) The income under a head of income for a tax year shall be the total chargeable amounts derived by the person under the head as reduced by the total deductions.
(3) Where total deduction allowed to a person for a tax year under a head of income exceed the total amounts chargeable to tax, the person shall be treated as sustaining a loss for that head.
(4) A loss for a head of income for a tax year shall be dealt with in accordance with Chapter 14.
(5) The income of a resident person under a head of income shall be computed by adding:
  - Pakistan-source income and
  - Foreign-source income.
(6) The income of a non-resident person under a head of income shall be computed by considering only amounts that are Pakistan-source income.

Residential status/Income	Pakistan Source income	Foreign source income
Resident	Taxable	Taxable
Non-resident	Taxable	Not taxable

DEDUCTIBLE ALLOWANCES

Zakat [Sec.60]
(1) A person shall be entitled to a deductible allowance for Zakat paid by the person in a tax year under the Zakat and Ushr Ordinance, 1980.
(3) An allowance for a tax year that is not fully deducted shall not be:
  - refunded;
  - carried forward to a subsequent tax year; or
  - carried back to a preceding tax year.

> Zakat paid to relatives will not be deducted because it is not considered as Zakat as per Zakat and Ushr Ordinance, 1980.
> If question is silent about Zakat, assume that Zakat is being paid under Zakat and Ushr Ordinance, 1980.

Workers' Welfare Fund [Sec.60A]

A person shall be entitled to a deductible allowance for the amount of any Workers' Welfare Fund paid by the person under Workers' Welfare Fund Ordinance or under any law relating to Workers' Welfare Fund enacted by provinces (after the 18th constitutional amendment Act, 2010):

No deductible allowance will be allowed for amount of WWF paid to Provinces by a trans-provincial establishment.

Workers' Participation Fund [Sec.60B]

A person shall be entitled to a deductible allowance for the amount of any Workers' Participation Fund paid by the person under Companies Profit (Workers' Participation) Act" or under any law relating to the Workers' Profit Participation Fund enacted by Provinces (after the 18th Constitutional amendment Act, 2010)

No deductible allowance will be allowed for amount of WPPF paid to Provinces by a trans-provincial establishment.

Calculate the tax liability in the questions given below assuming that all question relates to individual.

Question-1

Income from Business	400,000
Income from Salary	800,000
Income from other sources	500,000

Answer

Income from Business		400,000
Income from Salary		800,000
Income from other sources		500,000
Taxable Income		1,700,000
Tax Liability {70,000 + (15% x 500,000)}	(Table 1)	145,000

Question-2

Income from Business	200,000
Income from Salary	100,000
Zakat	10,000

Answer

Income from Business	200,000
Income from Salary	100,000
Total Income	300,000
Less: Zakat	(10,000)
Taxable Income	290,000
Tax Liability (Table 1)	-

Question-3

Income from Business	300,000
Income from Salary	200,000
Income from other sources	100,000
Zakat	20,000

Answer

Income from Business	300,000
Income from Salary	200,000
Income from other sources	100,000
Total Income	600,000
Less: Zakat	(20,000)
Taxable Income	580,000
Tax Liability (5% x 180,000) (Table 1)	9,000

Question-4

Income from Capital Gain	350,000
Income from Business	200,000
Zakat	150,000

Answer

Income from Capital Gain	350,000
Income from Business	200,000
Total Income	550,000
Less: Zakat	(150,000)
Taxable Income	400,000
Tax liability (Table 1)	-

Question-5

Income from Business	300,000
Income from Salary	500,000
Zakat	20,000

Answer

Income from Business	300,000
Income from Salary	500,000
Total Income	800,000
Less: Zakat	(20,000)
Taxable Income	780,000
Tax Liability {10,000 + (10% x 180,000)} (Table 1)	28,000

Question-6

Income from Other Sources	200,000
Income from Salary	600,000
Zakat	50,000

Answer

Income from Other Sources	200,000
Income from Salary	600,000
Total Income	800,000
Less: Zakat	(50,000)
Taxable Income	750,000
Tax Liability (5% x 150,000) (Table 2)	7,500

Question-7

Income from Salary	5,000,000
Income from Business	1,000,000
Income from Capital Gain	600,000

Answer

Income from Salary	5,000,000
Income from Business	1,000,000
Income from Capital Gain	600,000
Taxable Income	6,600,000
Tax Liability {670,000 + (22.5% x 1,600,000)} (Table 2)	1,030,000

Question-8

Income from business	600,000
Income from Salary	900,000
Zakat	80,000

Answer

Income from business	600,000
Income from Salary	900,000
Total Income	1,500,000
Less: Zakat	(80,000)
Taxable income	1,420,000
Tax Liability {70,000 + (15% x 220,000)} (Table 1)	103,000

Question-9

Income from Business	300,000
Income from Salary	3,000,000
Income from Other Sources	600,000
Zakat	150,000

Answer

Income from Business	300,000
Income from Salary	3,000,000
Income from Other Sources	600,000
Total Income	3,900,000
Less: Zakat	(150,000)
Taxable Income	3,750,000
Tax Liability {370,000 + (20% x 250,000)} (Table 2)	420,000

INDIVIDUALS

Principle of taxation of individuals [Sec. 86]

The taxable income of each individual shall be determined separately.

Deceased individuals [Sec. 87]

(1) The legal representative of a deceased individual shall be liable for –
 (a) any tax that the individual would have become liable if he had not died; and
 (b) any tax payable in respect of the income of the deceased's estate.

(2) The liability of a legal representative shall be limited to the extent of deceased's estate.

Example

Mr. Umer is appointed as a representative of his father who has passed away 2 months back. The value of assets left by father at time of his death amounted to Rs. 2 million however as per Commissioner income tax the tax payable by him was Rs. 3 million. How much amount Mr. Umer is required to pay?

Answer

The liability of Mr. Umer shall be limited to the extent of deceased's estate. Therefore he is only liable to pay Rs. 2 million.

(2A) The liability shall be the first charge on the deceased's estate.

Example

Mr. Umair is appointed as a representative of his deceased uncle. The value of assets left by his uncle at time of his death amounted to Rs. 5 million. As per Commissioner income tax the tax payable by him was Rs. 4 million. Further a bank loan of Rs. 2 million is also payable. How Mr. Umair should discharge the liabilities?

Answer

Firstly, he will make the payment of Rs. 4 million to Commissioner income tax as tax liability is the first charge on the deceased's estate. Remaining 1 million will be paid to the bank.

(3) For the purpose of this Ordinance, –
 (a) any proceeding taken against the deceased before his death shall be assumed as having been taken against the legal representative. The proceeding will be continued against the legal representative from the stage at which they were at the time of death; and
 (b) any proceeding which could have been taken against the deceased may be taken against the legal representative of the deceased.

(4) In this section, "legal representative" means a person:
- who in law represents the estate of a deceased person,
- who intermeddles with the estate of the deceased and
- on whom the estate devolves on the death of representative, if the representative is being sued in a case.

Authors [Sec. 89]
Where the time taken by an author of a literary or artistic work to complete the work exceeds 24 months, the author may elect any lump sum amount received in a tax year as royalties for the work as having been received in that tax year and the preceding 2 tax years in equal proportions.

Example
Mr. Asif received a lump sum amount of Rs. 6 million as the author of a literary work in TY 2014. Asif took 5 years to complete this literary work. How this amount will be taxed in his hands?
Answer
He can opt Rs. 2 million each to be taxed in TY 2012, 2013 and 2014.

Income of minor child [Sec 91]
Income from business of minor child is taxable in hands of parent who has highest taxable income.
Above provision will not apply if business is acquired through inheritance.
"Minor child" is an individual under age of 18 at end of tax year.

COMMON RULES

Income of joint owners [Sec 66]
Refer chapter of income from property

Apportionment of deductions [Sec 67]
(1) Where expenditure, deduction and allowances relates to –
- (a) the derivation of more than one head of income; or
- (ab) derivation of income comprising of:
  - taxable income and
  - income falling under final tax regime or;
- (b)
  - the derivation of income chargeable to tax under a head of income and
  - for some other purpose,

the expenditure, deduction and allowances shall be apportioned on any reasonable basis considering the relative nature and size of the activities.

Question-1
Mr. Riaz Ch. a resident person has disclosed following :

	Pakistan shop	Canada shop
Sales	300,000	700,000
Salaries	10,000	7,000

Advertisement expenditure incurred on a TV channel seen on both places is Rs. 5,000.
Required:
Calculate his total income.

Answer

Pakistan source income			
Sales		300,000	
Less: Salaries paid		(10,000)	
Advertisement	$5{,}000 \times \frac{300{,}000}{300{,}000 + 700{,}000}$	(1,500)	288,500
Foreign source income			
Sales		700,000	
Less: Salaries paid		(7,000)	
Advertisement	$5{,}000 \times \frac{700{,}000}{300{,}000 + 700{,}000}$	(3,500)	689,500
Total Income			978,000

Question-2
Assume all the data is same as in Question No. 1, except that Mr. Riaz Ch. is non-resident.
Required:
Calculate his taxable income.

Answer
Taxable income of Mr. Riaz Ch. is Rs. 288,500 because he is non-resident. No foreign source income is to be added in his taxable income.

Apportionment of Expenditure [Rule 13]

(2) Any expenditure that is incurred for a particular class or classes of income shall be allocated to that class.

(3) Any common expenditure, deductions and allowances which relates to business including presumptive (final) and exempt income, shall be allocated to each class of income according to the following formula:

$$\text{Amount of expense} \times \frac{\text{Gross receipt for a class of income}}{\text{Gross receipt for all class of income}}$$

"Gross receipts" are receipts without deduction of expenditures.
"common expenditure deductions and allowances means" any expenditure that is not clearly allocable to any particular class of income,.
Where a person is earning net commission or brokerage than his gross profit will be taken as turnover.

(8) In this rule. -
"class of income" means Pakistan and foreign source as follows-
(a) income chargeable under the head "Salary";
(b) income chargeable under the head "Income from Business";
(c) income from a speculation business chargeable under the head "Income from business";
(d) income chargeable under the head "Capital Gains";
(e) income chargeable under the head "Income from Other Sources"
(f) income chargeable under the head "Property"
(g) income exempt from tax;
(h) incomes chargeable as separate block; and
(i) incomes falling under final tax regime

While allocating expenses the nature and source of each class must be considered.
The basis for allocation of expenditure, deductions and allowances should be certified by a Chartered Accountant or a Cost and Management Accountant. This certificate shall be accepted by Commissioner unless there is significant variations (10% +/- beyond the limits) from allocation.

Fair market value [Sec 68]

(1) The FMV of any property or rent, asset, service, benefit or perquisite at a particular time shall be the price which will ordinarily be fetched on sale or supply in the open market at that time.

Mr. Amir purchased a computer for Rs. 70,000 and sold it to Mr. Anjum when the WDV in the Amir's books was Rs. 40,000. Its fair value in open market at time of sale was Rs. 42,000.
Conclusion
Fair value in this case is Rs. 42,000.

(2) The FMV shall be determined ignoring:
- any restriction on transfer or
- the fact that it is not convertible to cash.

(3) Where the price is not ordinarily ascertainable, the Board may, by notification in the official gazette determine the fair market value of the immoveable property.

(4) Where the fair market value of any immoveable property of an area has not been determined by the Board as above, the fair market value of such immoveable property shall be deemed to be the value fixed by the district officer (revenue) or provincial or any other authority authorized in this behalf for the purposes of stamp duty.

Receipt of income [Sec 69]
Discussed in Income form Salary Chapter

Recouped expenditure [Sec 70]
In case of subsequent recoupment of any expenditure or loss, in cash or kind, the recouped amount shall be included in the income chargeable under relevant head for the tax year in which it is received.

Example:
RISE got repaired its AC for Rs. 7,000 in TY 2010. The service provider realised in TY 2011 that he has charged Rs. 2,000 excess to RISE. So he returned the amount immediately.

Required:
Treatment of amount recovered by RISE in TY 2011.
Answer
The recouped amount shall be included in the income as Rs. 2,000 in TY 2011 by RISE chargeable under the head income from business.

Example
Sparkle company recorded interest payable to bank of Rs. 12,000 and Rs. 15,000 in TY 2017 and TY 2018 respectively. However the interest was not paid due to financial crisis. Bank waived the interest of Rs, 25,000 in TY 2019.
Conclusion
Rs. 25,000 is recouped expenditure and is chargeable as income in the tax year in which it is received i.e. TY 2019.

Currency conversion [Sec 71]
(1) Every amount taken into account under this Ordinance shall be in Rupees.
(2) Where an amount is in a currency other than rupees, conversion shall be at the State Bank of Pakistan rate prevailing at the date at which the amount is taken into account.

Mr. Qasim purchased an imported car for US$ 35,000 on March 31, 2009. The exchange rates on relevant dates are as follows:

	March 31, 2009	June 30, 2009
Open market rate	1 US $ = Rs. 102	1 US $ = Rs. 103
State bank of Pakistan rate	1 US $ = Rs. 102.1	1 US $ = Rs. 103.2

What is cost of car?
Solution
Cost = US$ 35,000 x Rs. 102.1 = Rs. 3,573,500

Cessation of source of income [Sec 72]
If a taxable source of income ceases to exist either:
- before the commencement of the year or
- during the tax year,

then any subsequent benefit derived from it shall be taxable in normal way assuming that the source has not ceased at the time income was derived.

Rules to prevent double derivation and double deductions [Sec 73]
If any income is taxed on receivable basis it shall not become taxable again on receipt basis and vice versa. Likewise, if any expenditure is deductible on payable basis the same shall not be deducted when it is paid and vice versa.

Tax on dividends [Sec. 5]
(1) A tax shall be imposed, at prescribed rate, on every person who receives a dividend from a company.
(2) The tax shall be computed by applying the rate of tax to the gross amount of the dividend.
(3) This section shall not apply to a dividend that is exempt from tax.

Every company paying a dividend shall deduct tax on gross amount of dividend.
Following are the rates of dividend:

Description	Rate
General tax rate	15.0%
Dividend paid by Independent Power Producer	7.5%
Certain other cases	25%

General provisions relating to taxes imposed under sections 5 and 7B [Sec. 8]

Rules applicable to income chargeable under final tax regime

The tax imposed under section 5 and 6 shall be a final tax and

(a) This income shall not be chargeable under any head of income;
(b) no deduction shall be allowable for any expense incurred;
(c) the income shall not be reduced by –
 (i) any deductible allowance (Zakat etc.); or
 (ii) the set off of any loss;
(d) the tax deducted shall not be reduced by any tax credit; and
(e) the liability of a person (under sections 5 or 6) shall be discharged if tax has been deducted.
(f) the person will be required to furnish a return of income.

The tax deducted on dividend is commonly known as non-adjustable tax.

What are different tax regimes?

1) **Normal Tax Regime** [S. 4 (1) and (2)]
Under this regime income is taxed on net basis (i.e. Gross amounts chargeable to tax less deductions).

2) **Final Tax Regime/Presumptive Tax Regime** [S. 4 (4) and (5)]
Under this regime tax will be deducted at the time of transaction by applying rate on gross receipt normally.
Following are the examples of income chargeable under this regime:
 a) Dividend Income [Sec. 5]
 b) Profit on debt in certain cases

3) **Minimum tax regime**
Some examples are as follows:
1. Minimum tax on turnover [S. 113 covered in business chapter]

4) **Separate block**
Following are the incomes which are charged at separate rates:
 a) Gain on disposal of immoveable property
 b) Gain on disposal of securities

Following is a summary of different tax regimes:

Normal tax regime (Net income basis)	**Separate block**	**Final/Presumptive tax regime (Gross income basis)**
- Income from salary - Income from capital gain - Income from business - Income from property - Income from other source **Total income** Less: Zakat **Taxable income**	- Gain on securities - Gain on disposal of immovable property	- Dividend income - Interest income in certain cases
Table 1 and 2 are used to calculate tax	Different slab rates are available as compared to Table 1 and 2	Different rates are there in law

ICAP PAST PAPER QUESTIONS

Question-1
What is total income? Does it differ in case of resident and non-resident? (6)
(Q.1 (a) May1997)

Question-2
Describe the common rules for treating the following under the Income Tax Ordinance, 2001?
(a) Receipt of income. (4)
(b) Currency conversion. (4)
(Q.2 September 2004)

Question-3
Discuss under what circumstances an expenditure incurred by a person are required to be apportioned for the purpose of claiming a deduction under the Income Tax Ordinance, 2001? (4)
(Q.7March 2005)

Question-4
Discuss the common rules with regard to the following under the Income Tax Ordinance, 2001:
(a) Fair Market Value. (3)
(b) Income of joint owners. (2)
(Q.2March 2005)

Question-5
(a) What do you understand by the concept "apportionment of expenditures" as explained in the Income Tax Ordinance, 2001? (6)
(b) One of your clients which is a subsidiary of a foreign company wants to change its accounting year from June 30 to December 31 as the income year of its parent company ends on December 31. Advise the client about the requirements of the Income Tax Ordinance, 2001 regarding change in tax year from normal to special. (3)
(Q.2 September 2007)

Question-6
Briefly explain the term "legal representative" with reference to the Income Tax Ordinance, 2001. What are the obligations of a legal representative? (6)
(Q.6(a) March 2009)

Question-7
(a) Hijazi Ltd is a multinational unquoted company. Presently, the company closes its financial year on June 30. The company is now considering to change its income year from June 30 to March 31.
Required: Mr. Safi is the tax consultant of the Company. Write a memorandum on his behalf, explaining the following:
(i) Requirements of the Income Tax Ordinance, 2001 regarding change in tax year from normal to special.
(ii) The tax year corresponding to the income year ended on March 31, 2009 and the due date for filing the return of income. [Note: It is a concept of Ch. 15] (5)
(b) Briefly discuss the residential status of the following persons under the Income Tax Ordinance, 2001 for the tax year 2009:
(i) Asif is an employee of Balochistan Government, who has been sent to United Kingdom for an official assignment on December 1, 2007 for two years.
(ii) Messrs. Akhtar Abbas & Co. is a partnership firm, doing business of financial consultancy in Pakistan as well as United Arab Emirates (UAE). The management and control of its affairs is situated partly in UAE and partly in Pakistan. (4)
(Q.2 March 2009)

Question-8
Mr. Zia's father expired in March 2009. Being the only heir, he received all his father's business and assets. In August 2009, a notice was received from the income tax department in the name of his father to pay unpaid tax liabilities along with penalty and additional tax. Mr. Zia is of the view that since his father expired, the notice is irrelevant.
Required:
In the light of Income Tax Ordinance, 2001, explain the correct legal position of Mr. Zia with regard to his father's income tax liabilities and the related income tax proceedings. (6)
(Q.6 (a) September 2009)

Question-9

State the provisions of the Income Tax Ordinance, 2001 regarding the residential status of companies and association of persons.

(5)

(Q.5 (a) March 2010)

Question-10

(a) Mr. Hyder is the legal representative of his deceased uncle since January 5, 2010 and manages his estate worth Rs. 10 million approximately. On August 10, 2010, he received two notices from the Income Tax Department requiring him to:

- submit details of his uncle's income for the tax year 2009.
- make payment of Rs. 12 million against his uncle's income for the tax year 2007 and 2008.

Required:

Advise Mr. Hyder about the extent of his tax liability in respect of the income earned by his uncle before January 5, 2010. Also advise him about his obligations relating to the tax assessment proceedings pending/arising against his uncle. (5)

(b) List the situations referred to in Income Tax Ordinance, 2001 where an expenditure is required to be apportioned for the purpose of claiming a deduction.

(4)

(Q.5 September 2010)

Question-11

Briefly discuss the residential status of the following persons for the tax year 2011 under the Income Tax Ordinance, 2001.

(i) Mr. Shah has been working as an Information Analyst in the Ministry of Foreign Affairs. On 1 November 2010, he was posted to Pakistan Embassy in Canada for three years.

(ii) Asif Learning Center is a partnership concern, providing IT training to professionals in Pakistan, UAE and Saudi Arabia. Up to 31 July 2010, the management and control of its affairs was situated partly in Pakistan. However, with effect from 1 August 2010, the entire management and control of the affairs of the partnership was shifted to Dubai.

(iii) Mr. Liaquat was sent to Pakistan on a special assignment by his UK-based company on 1 March 2011. He left Pakistan on 9 September 2011

(iv) Farooq Trading LLC was incorporated as a limited liability company in UAE. The management and control of its affairs are situated wholly in Pakistan.

(8)

(Q.4 (a) September 2011)

Question-12

Explain the following as specified in the Income Tax Ordinance, 2001.

(i) Fair Market Value (3)

(ii) Apportionment of Expenditures. (4)

(Q.4 (b) September 2011)

Question-13

State the provisions of the Income Tax Ordinance, 2001 regarding the residential status of companies and association of persons.

(5)

(Q.3 (a) September 2012)

Question-14

Deleted

Question-15

State the provisions of the Income Tax Ordinance, 2001 for determining the residential status of an Association of Persons.

(2)

(Q.3 (a) March 2013)

Question-16

Inspired Pakistan Limited (IPL) wants to change its accounting year from 30 June to 31 December as the income year of its parent company in USA ends on 31 December.

Required: Advise IPL about the requirements of the Income Tax Ordinance, 2001 regarding the change of tax year from normal to special.

(3)

(Q.4 (a) March 2013)

Question-17

In view of the provisions of Income Tax Ordinance, 2001 and Rules made thereunder, determine the residential status of the following persons for the tax year 2013:

(i) Ramiz proceeded to Saudi Arabia on 24 December 2012 to assume responsibilities on his new job. He visited Karachi from 20 June 2013 to 24 June 2013 for presenting a paper in a seminar but due to unavoidable circumstances, the seminar was cancelled.

(ii) Khalil, an officer working at Ministry of Foreign Affairs, since last three years, was posted to the Pakistan's mission in Geneva from 1 August 2012 to 30 June 2013.

(iii) Ali Associates is partnership firm and provides consultancy services in Pakistan as well as United Kingdom (UK). The management and control of its affairs is situated partly in UK and partly in Pakistan.

(iv) Smith, a Nigerian football coach, came to Pakistan on 28 February 2013. He left the country on 31 August 2013. **(7)**

(Q.4 (b) September 2013)

Question-18

One of your clients Inqalab Limited wants to change its accounting year.

Required:

Write a brief note to the Finance Manager of the company explaining the requirements of Income Tax Ordinance, 2001 as regards the following:

(i) Change in tax year. **(3)**

(ii) Determination of tax year and the date of filing of return in case the accounting year-end is changed from June to December. *[Note for students: It is a concept of Chapter 15]* **(5)**

(Q.5 (b) September 2013)

Question-19

Ahmed is responsible for managing the property of his uncle who died on 5 February 2013.The approximate worth of the property is Rs. 7 million. In August 2013, a notice was received from income tax department in the name of his uncle requiring details of his income for the tax year 2012 along with demand for payment of tax in respect of previous year amounting to Rs. 8.5 million.

Required:

Advise Ahmed as regards the following:

(a) Extent of Ahmed's liability in respect of the income earned by his uncle before 5 February 2013.

(b) His obligations relating to the tax assessment proceedings pending/arising against his uncle. **(5)**

(Q.6 September 2013)

Question-20

Under the provisions of the Income Tax Ordinance, 2001 explain the following:

(a) Special tax year **(03)**

(b) Transitional tax year **(03)**

(c) Order of application of various tax credits while computing the tax liability of the taxpayer **(03)**

(d) General provisions/rules which may apply to income subject to final tax. **(06)**

(Q.3 March 2016)

Question-21

The Income Tax Department initiating a proceeding against Mobeen, issued a demand note requiring him to pay the outstanding amount of his tax liability for tax year 2015 along with default surcharge. However, before settlement of his tax liability, Mobeen died in a car accident.

Required:

Under the provisions of the Income Tax Ordinance, 2001:

(i) describe whether tax authorities would be able to recover the amount of tax after Mobeen's death and what would be the extent of such recovery. **(03)**

(ii) comment on the status of the proceedings initiated against Mobeen. **(02)**

(Q.3 (a) September 2016)

Question-22

Mr. Danishwar, a renowned author, completed his book on "Human Behaviour" in two and a half years. He received a lump sum amount of Rs. 900,000 in May 2016 on account of royalty.

Discuss the taxability of Rs. 900,000 received by Mr. Danishwar.

Question-23

Under the provisions of the Income Tax Ordinance, 2001, state the situations where expenditure is required to be apportioned for the purpose of claiming a deduction. **(03)**

(Q.4 (a) September 2017)

Question-24

Under the provisions of Income Tax Ordinance, 2001 and rules made thereunder discuss the residential status for tax year 2017 in each of the following situations:

(i) On 21 September 2016 Asif proceeded to Dubai to join his new job. Due to certain professional issues with his employer in Dubai, he resigned on 1 May 2017 and came back to Pakistan. On 16 May 2017 he got a new job in Pakistan which he continued till 30 June 2017. (02)

(ii) Sami Associates is an association of persons and provides accounting services in Dubai. On 2 January 2017, the entire management and control of its affairs was shifted from Karachi to Dubai. (02)

(Q.2 (a) September 2017)

Question-25

On 1 December 20X7 Bruce Lee was appointed by a Chinese company as a Technical Director for Pakistan. He has provided you the following details:

Arrival in Pakistan	15 December 20X7
Joined office in Pakistan	20 December 20X7
Visit to Dubai on an official trip	21-30 March 20X8
Visit to South Korea for vacations	12-21 April 20X8
Visit to northern areas of Pakistan for personal trip	4-9 June 20X8

In view of the provisions of the Income tax Ordinance, 2001 and related Rules thereunder, comment on the residential status of Bruce Lee for the tax year 20X8. (03)

(Q.3 (c) March 2018)

Question-26

Kaleem Limited (KL) is a listed company and its accounting year ends on 30 June. KL is now considering to change its accounting year from 30 June to 30 September.

Under the provisions of the Income Tax Ordinance, 2001:

(a) briefly describe normal , special and transitional tax year. (06)

(b) state the requirements regarding change in tax year from normal to special. (02)

(c) state the tax year corresponding to the income year ended 30 September 20X8 and the due date for filing the return of income. *[Note for students: It is a concept of Chapter 15]* (02)

(Q.2 September 2018)

Question-27

Abid is the legal representative of his grandfather since his death on 10 July 20X7 and manages his estate worth Rs. 28 million. On 22 January 20X9, he received a notice from the Income Tax Department requiring him to make payment of Rs. 0.8 million against his grandfather's income for the tax year 20X7. The notice also required him to submit details of his grandfather's income for the tax year 20X8.

Required:

Advise Abid about his obligations relating to the tax assessment proceedings pending/arising against his grandfather. (05)

(Q.4 (c) March 2019)

Question-28

Jean Francois, a French designer, often visits to Pakistan for promotion of his products. During his last visit he stayed in Pakistan from 10 July 20X8 to 25 February 20X9. ***Determine the residential status of Jean Francois for tax year 20X9, assuming that the Commissioner has granted him permission to use calendar year as special tax year.*** (02)

(Q.3 (a) September 2019)

Question-29

General provisions/rules which may apply to income subject to Final Tax Regime. (06)

(Q.4 (b) September 2019)

Question-30

Briefly explain the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder relating to order of application of various tax credits if a taxpayer is allowed more than one tax credit for a tax year. (03)

(Q.4(b) (iii) March 2021)

ICAP PAST PAPER SOLUTIONS

Answer-1

Total income [S.10]

The total income of -

(a) Person's income under all heads of income for the year; and

(b) person's income exempt from tax under any of the provisions of this Ordinance.

Following are the heads:– [S.11]

a) Salary;
b) Income from property
c) Income from Business;
d) Capital Gains; and
e) Income from Other Sources.

Difference in case of resident and non-resident [S.11(5)]

The income of a resident person under a head of income shall be computed by taking into account amounts that are Pakistan-source income and amounts that are foreign-source income.

The income of a non-resident person under a head of income shall be computed by taking into account only amounts that are Pakistan-source income.

Answer-2

a) S. 69

b) S. 71

Answer-3

S. 67

Answer-4

a) S. 68

b) S. 66

Answer-5

a) S. 67

b) S. 74 (3),(5)

Answer-6

S. 87

Answer-7

a) i) S. 74 (3),(5)

ii) The TY will be Special TY 2009 and the due date for filing the return of income is December 31, 2009.

b) i) If a person is an employee or official of the Federal Government or a Provincial Government posted abroad in the tax year he will be considered as resident individual irrespective of the fact that how many days he is present in Pakistan. [S.82(c)]

Therefore, Asif being employee of Balochistan Government will be considered as resident.

ii) An association of persons shall be a resident association of persons for a tax year if the control and management of the affairs of the association is situated wholly or partly in Pakistan at any time in the year. [S.84]

As the management and control of affairs of Messrs. Akhtar Abbas &Co. is situated partly in UAE and partly in Pakistan therefore it is resident.

Answer-8

i) Mr. Zia being legal representative of his father (deceased individual) shall be liable for – [S.87]

a) any tax that Zia's father would have become liable for if he had not died; and

b) any tax payable in respect of the income of his father's estate.

The liability of Mr. Zia shall be limited to the extent to which his father's estate is capable of meeting the liability. The liability shall be the first charge on his father's estate.

ii) For the purpose of this Ordinance, – [S.87(3)]

a) any proceeding taken under this Ordinance against Zia's father before his death shall be treated as taken against Mr. Zia and may be continued against him from the stage at which the proceeding stood on the date of Zia's father's death; and

b) any proceeding which could have been taken under this Ordinance against Zia's father if he had survived may be taken against Mr. Zia

Answer-9

S. 83, 84

Answer-10

a) As a legal representative, Mr. Hyder is liable for any tax, which would have been payable by his uncle, if he had not died. However, such liability is limited to the extent of Rs. 10 million i.e. value of his deceased uncle's estate. [S.87(1),(2)]

Any proceeding taken against his uncle shall be continued against Mr. Hyder from the stage at which it stood on the date of his uncle's date. Further, any proceeding which could have been taken against the deceased if he had survived may be taken against the legal representative. [S.87(3)]

b) Section 67

Answer-11

i) An individual shall be a resident individual for a tax year if the individual is an employee or official of the Federal Government or a Provincial Government posted abroad in the tax year. Therefore Mr. Shah is a resident for TY 2011 irrespective of number of days he is present in Pakistan. [S.82(c)]

ii) An association of persons shall be a resident association of persons for a tax year if the control and management of the affairs of the association is situated wholly or partly in Pakistan at any time in the year. As the control was partly in Pakistan for 1 month in TY 2011 therefore Asif learning Centre is resident AOP. [S.84]

iii) An individual shall be a resident individual for a tax year if the individual is present in Pakistan for a period of, or periods amounting in aggregate to, 183 days or more in the tax year. Therefore he is not resident for TY 2011 because of number of days he is present in Pakistan from 1 March 2011 to 30 June 2011 are less than 183. [S.82(a)]

iv) A company shall be a resident company for a tax year if the control and management of the affairs of the company is situated wholly in Pakistan at any time in the year. Therefore Farooq Trading Company is resident company.[S.83]

Answer-12

i) Refer the chapter

ii) Refer the chapter

Answer-13

S. 82, 83

Answer-14

Deleted

Answer-15

S. 84

Answer-16

(1) A person may apply, in writing, to the Commissioner to allow him to use a 12 months' period, other than normal tax year, as special tax year and the Commissioner may, by an order, allow him to use such special tax year. The order will be passed by the Commissioner if the condition mentioned below is fulfilled. [S.74(3)]

(2) The Commissioner shall grant the permission to change the tax year only if the person has shown a compelling need. The permission shall be subject to such conditions as the Commissioner may impose.[S.74(5)]

Answer-17

i) Mr. Ramiz will be considered as non-resident as his stay in Pakistan is less than 183 days in Pakistan. Number of days he is present in Pakistan is calculated as follows:

July 1, 2012 – December 24, 2012	177
June 20, 2013 – June 24, 2013	5
Total	182

ii) An employee or official of the Federal Government or a Provincial Government posted abroad in the tax year will be considered as resident irrespective of number of days he is present in Pakistan. Therefore, Mr. Khalil working for Government will be considered as resident. [S.82(c)]

iii) An association of persons shall be a resident association of persons for a tax year if the control and management of the affairs of the association is situated wholly or partly in Pakistan at any time in the year. As management of the affairs of Ali Associates situated partly in Pakistan, therefore it will be considered as resident association. [S.84]

iv) Mr. Smith will be considered as non-resident as his stay in Pakistan is less than 183 days in Pakistan. Number of days he is present in Pakistan is calculated as follows:

February 28, 2013 – June 30, 2013	123

Answer-18

i) A person may apply, in writing, to the Commissioner to allow him to use a 12 months' period, other than normal tax year, as special tax year and the Commissioner may, by an order, allow him to use such special tax year. The order will be passed by the Commissioner if the condition mentioned below is fulfilled. [S.74(3)]
A person using a special tax year, may apply in writing, to the Commissioner to allow him to use normal tax year and the Commissioner may, by an order, allow him to use normal tax year. The order will be passed by the Commissioner if the condition mentioned below is fulfilled. [S.74(4)]
The Commissioner shall grant the permission to change the tax year:

- from normal to special or
- special to normal

only if the person has shown a compelling need. The permission shall be subject to such conditions as the Commissioner may impose. [S.74(5)]

ii) Where a person is allowed, to use a 12 months' period different from normal tax year, such period shall be that person's tax year (hereinafter referred to as **'special tax year'**) and shall, be denoted by the calendar year relevant to normal tax year in which the closing date of the special tax year falls. [S.74(2)]
The return will be filed on or before September 30^{th} next following the end of the tax year. [S.118(3)]

Answer-19

Same as Answer-10 (a)

Answer-20

(a) As per S.74, Where a person is allowed, to use a 12 months' period different from normal tax year, such period shall be that person's tax year (hereinafter referred to as **'special tax year'**) and shall, be denoted by the calendar year relevant to normal tax year in which the closing date of the special tax year falls.

(b) As per S.74(9), Where the tax year of person changes, the period between:

- the end of the last tax year prior to change and
- the date on which the changed tax year commences

shall be treated as a separate tax year, to be known as the "transitional tax year".

(c) As per S. 4 (3), Where a taxpayer is allowed more than one tax credit for a tax year, credits shall be applied in following order:

a. foreign tax credit (allowed under section 103); then
b. tax credit allowed on charitable donations, tax credit for investment in shares and insurance, tax credit on contribution to approved pension fund and tax credit on profit on debt (u/s 61-64); and then
c. tax credit for advance tax paid and tax deducted.

(d) Following are the characteristics of final tax regime:

(a) This income shall not be chargeable under any head of income;
(b) no deduction shall be allowable for any expense incurred;

(c) the income shall not be reduced by –
   (i) any deductible allowance (Zakat etc.); or
   (ii) the set off of any loss;
(d) the tax deducted shall not be reduced by any tax credit;
(e) the liability of a person shall be discharged if tax has been deducted.
(f) the person will be required to furnish a return of income

Answer-21

i. Deceased individual.

Yes tax authorities would be able to recover the amount of outstanding liability from legal representative of Mobeen.

The legal representative of a Mobeen shall be liable for –

i. any tax that the Mobeen would have become liable if he had not died; and
ii. any tax payable in respect of the income of the Mobeen's estate.

The liability of a legal representative shall be limited to the extent of Mobeen's estate. Such liability shall be the first charge on the Mobeen's estate.

ii. Comment

Any proceeding taken against Mobeen before his death shall be assumed as having been taken against the legal representative. The proceeding will be continued against the legal representative from the stage at which they were at the time of death.

Answer-22

Section 89 of ITO 2001 states that where the time taken by an author of a literary or artistic work to complete the work exceeds twenty-four months, the author may elect to treat any lump sum amount received by the author in a tax year on account of royalties in respect of the work as having been received in that tax year and the preceding two tax years in equal proportions.

Therefore, Mr. Danishwar can spread the amount of Rs. 900,000 over the period of three years in equal proportions i.e. Rs. 300,000 each starting from tax year 2016 to preceding two tax years 2015 and 2014.

Answer-23

S. 67

Answer-24

i) An individual shall be a resident individual for a tax year, if the individual is present in Pakistan for a period of or periods amounting in aggregate to 183 days or more in a tax year. As Mr. Asif stayed in Pakistan for just 144 days (as calculate below) so he will be considered as non-resident individual for tax year 2017.

Month	Days
July	31
August	31
September	21
May	31
June	30
	144

ii) An association of persons shall be a resident association of persons for a tax year if the control and management of the affairs of the association is situated wholly or partly in Pakistan at any time in the year. As management of the affairs of Sami Associates were situated partly in Pakistan before 2 January, 2017 therefore it will be considered as resident AOP irrespective of the fact that its entire management and control of affairs was subsequently shifted from Karachi to Dubai. [S.84]

Answer-25

An individual shall be a resident individual for a tax year if the individual is present in Pakistan for a period of, or periods amounting in aggregate to, 183 days or more in the tax year.

A part of a day that an individual is present in Pakistan (including the day of arrival in, and the day of departure from, Pakistan) counts as a whole day of such presence. (Rule 14 (a))

Month	No. of days
December	17
January	31
February	28
March	21
April	20
May	31
June	30
Total	**178**

Since he was present in Pakistan for 178 days, therefore, he is not a resident individual.

Answer-26

a) S. 74 (1) , (2) , (9)

b) **Change of tax year from normal to special:**

- A person using a special tax year, may apply in writing, to the Commissioner to allow him to use 12 months' period other than normal tax year as special tax year and the Commissioner may allow him.
- The Commissioner shall grant the permission to change the tax year only if the person has shown a compelling need. The Commissioner may impose conditions while giving permission.

c) Tax year corresponding to the income year ended 30 September 20X8 will be tax year 20X9 and due date of filing of return is 30 September 20X9.

Answer-27

- Any proceeding taken against the deceased (grandfather) before his death shall be assumed as having been taken against the legal representative (Abid). The proceeding will be continued against the legal representative (Abid) from the stage at which they were at the time of death; and
- any proceeding which could have been taken against the deceased (grandfather) may be taken against the legal representative (Abid) of the deceased. **[Sec. 87]**

Answer-28

The Commissioner has granted permission to Jean Francois to use special tax year, so his special tax year 20X9 will be from 1 January 20X8 to 31 December 20X8. As a result, John is a non-resident person because his total stay in tax year 20X9 is 175 days (i.e. 22+31+30+31+30+31) which is less than 183 days. Therefore, Jean Francois is non-resident person for tax year 20X9.

Answer-29

Refer Sec. 8

Answer-30

Same as Question 20 (c)

OTHER QUESTIONS

Question	Solution
a) In view of the provisions of Income Tax Ordinance, 2001 and the stated rules, determine the residential status of the following persons for the tax year ended June 30, 20X2 under the given circumstances.	
• Mr. Junaid came to Pakistan for the first time on a special assignment from his company on April 01, 20X1 and left the country on September 30, 20X1.	Non-Resident (total 92 days stay)
• Mr. Rana, who had never travelled abroad in his life, got a job in Canada. He went to Canada on December 29, 20X1 to assume his responsibilities as a CFO. In June, 20X2 his company sent him to India on a training workshop. On June 30, 20X2 on his way back to Canada he had to stay in Karachi for a whole day in transit.	Non-Resident (total 182 days)
• Mr. Baber, a Federal Government Employee was posted to the Pakistan mission in Geneva from July 01, 20X1 to June 30, 20X2.	Resident due to Federal Govt. employee

DEFINITIONS

5

1. (29C) "Industrial undertaking
2. (23) "Fee for technical services
3. Associates [Sec. 85]
4. (45) "private company"
5. (47) "public company"
6. (1) Accumulated profits
7. (19) "Dividend"
8. (5) "assessment"
9. (5A) "assessment year"
10. (11A) "charitable purpose"
11. (19C) "electronic record"
12. (29) "income"
13. (29A) "income year"
14. (36) "non-profit organization"
15. (53) "resident taxpayer"
16. (38) "non-resident taxpayer"
17. (44A) "principal officer"
18. (66) "taxpayer"
19. (63) "Tax"
20. (8) "Board"
21. (54) "Royalty"

CHAPTER 5
DEFINITIONS

(29C) "Industrial undertaking" means –

(a) An undertaking set up in Pakistan and which employs:

i. 10 or more persons and involves the use of electrical energy or any other energy which is mechanically transmitted and is not generated by human or animal energy; or

ii. 20 or more persons and does not involve the use of electrical energy or any other energy which is mechanically transmitted and is not generated by human or animal energy and

iii. And is engaged in,-

(i) - the manufacture of goods or materials or
- the processing goods in a way which substantially changes their original condition;

(ii) ship-building;

(iii) generation, conversion, transmission or distribution of electrical energy; or

(iv) the working of any mine, oil-well or any other source of mineral deposits;

(aa) a person doing construction of buildings, roads, bridges and other such structures (including the development of land), for import of plant and machinery to be used (applicable from 1.5.20),

(ab) a resident company engaged in the hotel business in Pakistan (applicable from 1.7.20);

(c) telecommunication companies (operating under the license of Pakistan Telecommunication Authority (PTA));

(23) "Fee for technical services" means amount received whether periodical or lump sum, for rendering of managerial, technical or consultancy services (including the services of technical or other personnel), but does not include:-

(a) Amount received for services rendered for a construction, assembly or like project; or

(b) receipt which is chargeable under the head "Salary";

Associates [Sec. 85]

(1) Two persons shall be associates where the relationship between the two is such that:
- One is expected to act in accordance with the intentions of the other, or
- Both are expected to act in accordance with the intentions of a third person.

(2) Two persons shall not be associates solely because:
- one person is an employee of the other or
- both are employees of a third person.

(3) Subject to sub- section (4), the following shall be treated as associates –

(a) an individual and a relative of the individual;

(b) members of an AOP;

(c) a member of an AOP and the AOP, where the member,
- either alone or
- together with an associate or associates under another application of this section

controls 50% or more of the rights to income or capital of the association;

(d) a trust and any person who benefits under the trust;

(e) a shareholder in a company and the company, where the shareholder,
- either alone or
- together with an associate or associates,

controls either directly or through one or more interposed persons –

(i) 50% or more of the voting power in the company;

(ii) 50% or more of the rights to dividends; or

(iii) 50% or more of the rights to capital; and

(f) two companies, where a person,
- either alone or
- together with an associate or associates,

controls either directly or through one or more interposed persons –

(i) 50% or more of the voting power in both companies;

(ii) 50% or more of the rights to dividends in both companies; or

(iii) 50% or more of the rights to capital in both companies.

Example 1

ABC Co. has the following shareholders:

LM AOP	55%
M	20%
N	10%
Q	10%
R	5%

LM AOP and ABC CO. are associates because LM AOP holds more than 50% shares in ABC Co.

Example 2

XYZ Co. has the following shareholders:

NA AOP	45%
R	10%
N	20%
Q	10%
M	10%
G	5%

You have also been informed that R and N are members of NA AOP having 60% and 40% share of profits respectively and N is not expected to act in accordance with the intentions of R.

Following are associates:

- R and NA AOP
- NA AOP and XYZ Co.
- R and XYZ Co.

As N is not expected to act in accordance with the intentions of R so N and R are not associates. However NA AOP and R are associates because R shares more than 50% profits of NA AOP.

Further NA AOP and XYZ Co. are associates because NA AOP alongwith an associate, R, holds more than 50% shares in XYZ Co.

Similarly R and XYZ Co. are associates because R alongwith an associate, NA AOP, holds more than 50% shares in XYZ Co.

(4) Relatives and members of an AOP shall not be associates [under clause (a) or (b) of subsection (3)] where Commissioner is satisfied that no one is expected to act in accordance with the intentions of the other.

(5) In this section, relative in relation to an individual means:

a)

- an ancestor,
- a descendant of any of the grandparents,
- or an adopted child, of the individual, or of a spouse of the individual; or

b)

- a spouse of the individual or
- spouse of any person specified in above clause (a)

(45) **"private company"** means a company that is not a public company

(47) **"public company"** means –

(a) a company in which at least 50% of the shares are held by the Federal or Provincial Government;

(ab)

- a company in which at least 50% of the shares are held by a foreign Government, and
- a company in which at least 50% of the shares are held by foreign company owned by a foreign Government;

> Example
>
> China Government owns 100% shares of a foreign company X. Company X owns 70% shares in Co. Q. Whether Co. Q will be considered as a public company?
>
> Solution
>
> Yes, because Q company is a company in which 70% of the shares are held by foreign company X which is owned by a foreign Government (Government of China).

(b) a company whose shares:

- were traded on a registered stock exchange in Pakistan at any time in the tax year and
- remains listed on that exchange at the end of year; or

(d) a unit trust whose units are widely available to the public;

Question

Explain whether the following companies are public or private?

1 Sitara Chemical Limited (SCL) incorporated under Companies Act, 2017. It is a non-listed company. Ching Chonge Limited (CCL), a company incorporated in Japan, holds 63% of shares in SCL. 84% of shares in CCL are held by Japanese government.

2 MN Limited is a public company incorporated under Companies Act, 2017. The shares of MN limited were traded on Karachi Stock Exchange (KSE) from 1st October 2013 to 29 June 2014. On 29 June 2014 Company was delisted from KSE.

3 Star Limited, a public company incorporated under Companies Act, 2017, is a unlisted company whose 50% shares are held by Federal Government.

4 Moon Limited is a public unlisted company, whose 43% of shares are held by Provincial Government, 50% by UAE Government and 7% by Sun Limited.

Answer

1. A public company means a company in which not less than 50% percent of the shares are held by a foreign government, or a foreign company owned by a foreign government. CCL is not wholly owned by the Japanese government so Sitara Chemical Limited is not a public company.
2. A company whose shares were traded on a registered stock exchange in Pakistan at any time in the tax year which remained listed on that exchange at the end of that year. So MN Limited is not a public listed company.
3. A public company means a company in which not less than fifty percent of the shares are held by Federal Government or Provincial Government. So Star Limited is a public company.
4. A public company means a company in which not less than fifty percent of the shares are held by a foreign government, or a foreign company owned by a foreign government. So Moon Limited is a public company because UAE Government holds 50% shares of Moon Limited.

(1) **"Accumulated profits"** for payment of dividend, include –

(a) any reserve made up from any allowance, deduction, or exemption under this Ordinance;

(b) all profits of the company including incomes/gains of a trust up to the date of distribution; and

(c) all profits of the company including incomes/gains of a trust up to the date of its liquidation;

(19) **"dividend"** includes:

(a) any distribution by a company of accumulated profits to its shareholders, whether capitalised or not, if such distribution requires the release of assets (including money) by the company;

EXPLANATION

Requires the release of assets including money

Accumulated profits (Dividend)	Dr.	
Bank		Cr.

(b) any distribution by a company to its shareholders of debentures, whether with or without profit (interest), upto the extent of accumulated profits whether capitalised or not;

EXPLANATION

A company announced the dividend and issued debentures in lieu of dividend. So, following entries shall be passed;

Accumulated Profit (Dividend)	Dr.	
Debentures payable (Loan payable)		Cr.

➢ **Whether with or without profit**. i.e. interest bearing or non interest bearing

(c) any distribution by a company to its shareholders on its liquidation, upto the extent of accumulated profits whether capitalised or not;

(d) any distribution by a company to its shareholders on the reduction of capital, upto the extent of accumulated profits whether capitalised or not;

(e) the payment by a private company as defined in the Companies Act, 2017 or trust:

- by way of advance or loan to a shareholder or
- for the individual benefit of a shareholder,

The payment should be from accumulated profits.

In case loan/advance is repaid by shareholder, the tax on dividend will be refunded.

Tax implications of the **loan/advance transaction** on the shareholder as well as the company:

If loan provider is:	Implication on shareholder	Implication on company
Private Company	Treated as dividend income in the hands of share holder	Company will deduct tax on dividend income
Public listed/unlisted Company	No tax implication	No tax implication

(f) Remittance (to head office) of after tax profit of a branch of a foreign company in Pakistan;

Following payments will not be considered as dividend:

(i) A distribution on liquidation or reduction of capital (for shares issued against cash), where shareholder has no right in surplus assets on liquidation;

(ii) any advance/loan by a company involved in lending business;

(iii) any dividend paid by a company which is set off against amount previously paid by it and treated as a dividend (under sub-clause (e)); and

(iv) Remittance (to head office) of after tax profit by a branch of Petroleum Exploration and Production foreign company.

Example

(a) Grey Enterprises Limited(GEL) is under the process of liquidation. The shareholders are paid Rs. 15/share (Rs. 10 being the par value and Rs. 5 as share of accumulated profits) on 31.07.20X6. Mr. A holds 20,000 shares in GEL. What amount is taxable in the hands of Mr. A as dividend under ITO, 2001?

(b) House Pvt. Limited (HPL) is engaged in the business of purchasing/selling of commercial & residential property. HPL extended a loan to one of its shareholder, Mr. A, amounting to Rs. 5 Million on 25.10.20X6. What amount is taxable in the hands of Mr. A as dividend under ITO, 2001?

(c) Shepard Petroleum (SP), incorporated in Seattle USA, is engaged in the business of exploration and production of Oil around the globe. The Pakistani branch of SP has remitted Rs. 23 Million as Interim Profit after tax to its head office in Seattle. What is the amount of tax that should be deducted by the branch as 'tax on dividend' while remitting the profits?

Answer

(a) Rs. 100,000 (20,000 x 5) is taxable as dividend under ITO, 2001.

(b) Rs. 5 million is taxable as dividend under ITO, 2001.

(c) Nothing as it is a branch engaged in exploration and production of Oil.

(5) "**assessment**" includes provisional assessment and amended assessment;

(5A) "**assessment year**" means assessment year as defined in the repealed Ordinance;

(11A) "**charitable purpose**" includes relief of the poor, education, medical relief and the advancement of any other object of general public utility;

(19C) "**electronic record**" includes the contents of communications and transactions under this Ordinance, including attachments, annexes, accounts, returns, notices, and any other associated information created, sent, forwarded, downloaded, read, or printed, by one or several electronic resources.

(29) "**income**" includes:

- any amount chargeable to tax under this Ordinance,
- any amount subject to collection or deduction of tax which is treated as final tax
- any amount treated as income under any provision of this Ordinance and
- any loss of income

(29A) "**income year**" means income year as defined in the repealed Ordinance.

(36) "**non-profit organization**" non-profit organization means any person other than an individual, which is

(a) established for religious, educational, charitable, welfare purposes for general public , or for promoting an amateur sport;

(b) formed by or under a law as a non-profit organization;

(c) approved by the Commissioner for specified period, on an appeal in prescribed form, accompanied by the prescribed documents and

(d) the person do not derive any benefit from the assets.

(53) "**resident taxpayer**" means a taxpayer who is a resident person;

(38) "**non-resident taxpayer**" means a taxpayer who is a non-resident person;

(44A) "**principal officer**" with reference to a company or an association of persons includes –

(a) a director, a manager, secretary, agent, accountant or any similar officer; and

(b) any person connected with the management or administration of the company or an AOP on whom the Commissioner has served a notice treating him as the principal officer

(66) "**taxpayer**" means any person who derives an amount chargeable to tax, and includes:

(a) any representative of a person who derives an amount chargeable to tax under this Ordinance;

(b) any person who is required to deduct or collect tax; or

(c) any person required to furnish a return of income or pay tax under this Ordinance;

(63) "**Tax**" means any tax imposed under this law, and includes any penalty, fee or other charge or any sum or amount leviable or payable under this law.

(8) "**Board**" means the Federal Board of Revenue.

(54) **"Royalty"** means any amount paid or payable, however described or computed, whether periodical or a lump sum, as consideration for -

(a) the use of, or right to use any
   i. patent (right to use name),
   ii. invention,
   iii. design or model,
   iv. secret formula or process,
   v. trade mark or
   vi. other like property or right;

(b) the use of, or right to use any copyright of a literary, artistic or scientific work, including films or video tapes for use in connection with television or tapes in connection with radio broadcasting, (e.g. PTV pays royalty for broadcasting an ESPN cricket documentary); BUT shall not include consideration for the sale, distribution or exhibition of cinematograph films

(c) the receipt of, or right to receive, any
   i. visual images or
   ii. sounds, or
   iii. both,

   transmitted by satellite, cable, optic fiber or similar technology in connection with television, radio or internet broadcasting;

(d) The supply of any technical, industrial, commercial or scientific knowledge, experience or skill;

> Difference with fee for technical services.
>
> Fee for Technical services:
>
> "Consideration for RENDERING of any managerial, technical or consultancy services including the services of technical or other personnel"
>
> Royalty:
>
> "Consideration for SUPPLY of any technical, industrial, commercial or scientific knowledge, experience or skill"
>
> There is a transfer of knowledge in royalty in contrast with fee for technical services which involves actual rendering of services.

(e) the use of or right to use any industrial, commercial or scientific equipment

(f) the supply of any assistance that is ancillary and subsidiary to any property or right as mentioned in sub- clauses (a) through (e); and it is furnished as a means of enabling the enjoyment of any property or right. and

(g) the disposal of any property or right referred to in sub- clauses (a) through (e);

ICAP PAST PAPER QUESTIONS

Question-1

Rose Company Ltd. has a paid up capital of Rs.5,000,000 consisting 500,000 shares of Rs.10 each. On 30.6.2001 the company's balance sheet shows accumulated profits of Rs.1,500,000. The company has to be liquidated. The official liquidator realized Rs.6,500,000 and distribution among the shareholders was made at the rate of Rs.13 per share. Shewani Group owns 200,000 shares in the company.

How much of the amount received by Shewani Group is dividend? Please explain your answer. **(4)**

(Q.1(b)September 2002)

Question-2

Define the following with reference to the Income Tax Ordinance, 2001?

(a) Fee for technical services **(3)**
(b) Non-profit organization **(3)**
(c) Income **(3)**
(d) Taxpayer **(2)**

(Q.1September 2004)

Question-3

Identify the situations in which two companies shall be considered to be associates within the meaning of the Income Tax Ordinance 2001. **(6)**

(Q.5 (a) September 2007)

Question-4

Certain types of payments by a private company to their shareholders can be treated as "dividend" under the Income Tax Ordinance, 2001. State the conditions necessary for the application of this rule and the exceptions to it. **(5)**

(Q.4 (b) March 2008)

Question-5

State the circumstances when two companies shall be considered as associates, under the Income Tax Ordinance, 2001. **(4)**

(Q.5 (b) September 2008)

Question-6

A company engaged in manufacturing activities has decided to provide loan to one of its shareholders. Explain the tax implication on the company as well as the shareholder if the Company:

(i) is registered under the Companies Act, 2017 as a private limited company.
(ii) is an unlisted public company. **(6)**

(Q.2 (a) September 2009)

Question-7

Tamba Pakistan (Pvt.) Limited is engaged in the manufacture of pharmaceutical products. Its board of directors has approved a 3-year loan to one of its major shareholders.

Required:

Explain the tax implications of the above transaction on the company as well as the shareholder. **(4)**

(Q.5 (a) March 2012)

Question-8

Under the Income Tax Ordinance 2001, where a person is reasonably expected to act in accordance with the intentions of another person, both persons are considered as associates.

Required:

(i) Explain the term "person" in the above context. **(3)**
(ii) State the circumstances in which a company and its shareholder shall be considered as associates. **(4)**

(Q.6 (b) March 2012)

Question-9

Differentiate between 'Public company' and 'Private company' within the meaning of Income Tax Ordinance, 2001. **(5)**

(Q.5 (a) September 2013)

Question-10

Under the provisions of Income Tax Ordinance, 2001:

Explain the term 'Associates'. State the circumstances under which a shareholder in a company and the company may be regarded as associates. **(5)**

(Q.2 (b) March 2014)

Question-11

Certain payments made by a private limited company to its shareholders can be treated as 'dividend'. Explain the above in the context of Income Tax Ordinance, 2001. Also identify the exceptions to this rule.

(7)

(Q.7 March 2014)

Question-12

Briefly discuss the provisions of Income Tax Ordinance, 2001 in respect of the following situation:
ABC (Private) Limited has decided to provide a loan of Rs. 5 million to one of its shareholders, for the purchase of a house.

(4)

(Q.2 (b) September 2014)

Question-13

Under the provisions of the Income Tax Ordinance, 2001 describe the following:

(i) meaning of the term 'Associates'. (2)

(ii) circumstances in which a member of an association of persons and the association may be regarded as associates. (2)

(iii) situation in which members of an association of persons may not be regarded as associates. (2)

(Q.3 (b) September 2016)

Question-14

On 25 August 20X8, the Officer of Inland Revenue has issued a notice to Rahat Foods (Private) Limited (RFPL) to deposit withholding income tax of Rs. 1,950,000 in respect of loan amounting to Rs. 13,000,000 given to Nadeem Ahmad, a shareholder of RFPL, by treating the amount of loan as dividend. The notice was served to the company on 30 August 20X8.

According to RFPL's records, the loan was given to Nadeem Ahmad on 25 May 20X7 when accumulated profit of the company was Rs. 12,000,000.

In the light of the provisions of the Income Tax Ordinance, 2001 explain whether you agree with the notice issued to RFPL by the Officer of Inland Revenue.

(03)

(Q.4 (a) September 2018)

Question-15

(a) Briefly discuss the difference between a public company and a private company, within the meaning of Income Tax Ordinance, 2001. (04)

(b) Certain types of payments by a private company to its shareholders can be treated as 'dividend' under the Income Tax Ordinance, 2001. State the conditions necessary for the application of this rule and the exceptions to such rule. (05)

(Q.5 March 2019)

Question-16

Explain Industrial Undertaking as specified in the Income Tax Ordinance, 2001.

(5)

(Q.4 (b) September 2011)

Question-17

Dr. Jamal is planning to establish a hospital as a non-profit organization.

Required:

Discuss the conditions that should be complied with by Dr. Jamal, under the Income Tax Ordinance, 2001. (03)

(Q.1(b) March 2021)

ICAP PAST PAPER SOLUTIONS

Note: Few of the questions are not answered below.

Answer-1

Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is from the accumulated profits of the company whether capitalised or not is treated as dividend.

Therefore Rs. 3 x 200,000 = 600,000 will be treated as dividend in the hands of Shewani Group.

Rs. 3 is calculated as (1,500,000/500,000)

Answer-3

S. 85(3) (f)

Answer-4

The payment made (from accumulated profits) by a private company as defined in the Companies Act, 2017 of any amount (whether it is a part of the assets of the company or trust, or otherwise)

- by way of advance or loan to a shareholder
- for the individual benefit of a shareholder

shall be treated as dividend under the Income Tax Ordinance, 2001.

Exception

Following payments will not be considered as dividend:

(i) any advance/loan by a company involved in lending business;

(ii) any dividend paid by a company which is set off against amount previously paid by it and treated as a dividend.

Answer-6

i. If the company is private limited company.

Tax implications on shareholders

The term dividend includes any payment by a private limited company by way of loan to its shareholder for the individual benefit of shareholder to the extent of accumulated profits. Accordingly, amount received by the shareholder shall be construed as dividend in the hands of the shareholder and taxable under the provisions of the ITO-2001.

Tax implications on private limited company

Being a private company, it is responsible to deduct withholding tax on the payment of dividend at the rates specified in the First Schedule.

ii. If the company is an unlisted public company, the payment made to the shareholders will not be construed as dividend. So no tax implication on the company or the shareholder.

Answer-7

Implications from point of view of shareholder

The payment made by a private company as defined in the Companies Act, 2017 of any amount by way of advance or loan to a shareholder shall be considered as dividend.

Therefore the amount received by shareholder will be treated as dividend income in his hands.

Implications from point of view of company

Every person paying a dividend shall deduct tax from the gross amount of the dividend paid at the rate of 15% of gross amount of dividend. Therefore company is required to deduct tax @ 15% of gross amount of dividend.

Answer-8

i) Refer Chapter-4

ii) S. 85(3)(e)

Answer-9

Refer definitions.

Answer-10
Two persons shall be associates where the relationship between the two is such that one is expected to act in accordance with the intentions of the other, or both are expected to act in accordance with the intentions of a third person.
And S. 85(3) (e)

Answer-11
The payment by a private company as defined in the Companies Act, 2017 or trust by way of advance or loan to a shareholder or for the individual benefit of a shareholder shall be considered as dividend. The payment should be from accumulated profits.

Following payments will not be considered as dividend:
(i) any advance/loan by a company involved in lending business;
(ii) any dividend paid by a company which is set off against amount previously paid by it and treated as a dividend.

Answer-12
The payment by a private company as defined in the Companies Act, 2017 or trust by way of advance or loan to a shareholder or for the individual benefit of a shareholder. The payment should be from accumulated profits. Therefore it is considered as dividend in the hands of shareholder and company is required to deduct tax at the rate of 15% on the gross amount of dividend.

Answer-13
i. **Associates**
Two persons shall be associates where the relationship between the two is such that:
- One is expected to act in accordance with the intentions of the other, or
- Both are expected to act in accordance with the intentions of a third person.

ii. A member of an AOP and the AOP, where the member,
- either alone or
- together with an associate or associates under another application of this section controls 50% or more of the rights to income or capital of the association

iii. Members of an AOP shall not be associates where Commissioner is satisfied that no one is expected to act in accordance with the intentions of the other.

Answer-14
"Dividend" includes the payment by a private company as defined in the Companies Act, 2017 or trust:
- by way of advance or loan to a shareholder or
- for the individual benefit of a shareholder,

The payment should be from accumulated profits.

Considering the above definition of dividend, the tax officer is correct to the extent of treating the loan payment as dividend. However, he made error in treating the entire amount of Rs.13 million as dividend because the amount of accumulated profit was Rs.12 million on that date. Therefore, only Rs.12 million can be treated as dividend.

Answer-15
a) S. 2 (45), (47)
b) Dividend includes the payment by a private company as defined in the Companies Act, 2017 or trust:
- by way of advance or loan to a shareholder or
- for the individual benefit of a shareholder,

The payment should be from accumulated profits.
Following payments will not be considered as dividend:
(i) any advance/loan by a company involved in lending business;
(ii) any dividend paid by a company which is set off against amount previously paid by it and treated as a dividend.

<u>Answer-16</u>
Refer the chapter above.

<u>Answer-17</u>
An individual cannot form a non-profit organization. However Dr. Jamal can run his clinic as a non-profit organization:

(a) established for charitable purpose
(b) formed under a law as a non-profit organization;
(c) approved by the Commissioner for specified period, on an appeal in prescribed form, accompanied by the prescribed documents and
(d) the person do not derive any benefit from the assets.

OTHER QUESTIONS

Questions	Treatment
a) A person has employed 17 persons for the manufacturing of room carpets. Explain under two independent scenarios whether he will be considered as industrial undertaking or not. • He uses human energy. • He uses electrical energy.	[Sec.2(29C)(a)(i)(ii)) • Not an industrial undertaking • It is an industrial Undertaking
b) Company XYZ a listed company has 70% shareholding in both of two companies: • ABC Private limited company • DEF Private limited company What is the status of all of the above three companies under the law?	Following are associates: • ABC and XYZ [S. 85(3)(e)] • DEF and XYZ [S. 85(3)(e)] • ABC and DEF [S. 85(3)(f)]
c) What would be your answer if the company XYZ in above example is a private company?	No change in answer
d) A company is going to wound up in TY 2011. A shareholder named Mr. Asim is going to receive 5 tola gold whose market value is Rs. 300,000/tola as his final share. His original investment was Rs. 130,000. How the whole amount received will be taxed in the hands of Asim?	Only Rs. 170,000 will be treated as dividend income. The other amount is a repayment of principal.

TAX CREDITS

6

1. Charitable Donations [Sec.61]
2. Tax credit for Investment in shares and insurance [Sec.62]
3. Tax credit for investment in health insurance [Sec.62A]
4. Contribution to approved pension fund [Sec.63]
5. Deductible allowance for Profit on debt [Sec. 60C]
6. Deductible allowance for educational expenses [Sec. 60D]
7. Tax credit for certain persons [Sec 65F]
8. Tax credit for specified industrial undertakings [Sec 65G]
9. Tax credit for point of sale machine [Sec 64D]
10. Miscellaneous provisions relating to tax credits [Sec. 65]
11. Full Time Teacher Allowance
12. Foreign tax credit [Sec. 103]
13. Small and Medium Enterprises [Sec 2(59A) read with 14TH Schedule]
14. Women Enterprise and its taxation [Clause 19 Part III of Second Schedule]

CHAPTER 6
TAX CREDITS

S.	Nature	Description	Formula	Limits = C is the lower of	Other considerations
61	Charitable Donations	A person shall be entitled to a tax credit for a tax year for amount paid or property given as a donation, voluntary contribution or subscription to: (a) any board of education or any university in Pakistan established by, or under, a Federal or a Provincial law; (b) any educational institution, hospital or relief fund established in Pakistan by Federal, Provincial or a Local Government; or (c) any non-profit organization or any persons eligible for tax credit under section 100C; and (d) entities, organizations and funds mentioned in 13th Schedule of the Ordinance.	(A/B)x C	(a) the amount of the donations in the year, including the fair market value of property given (b) where the person is – (i) an individual or AOP, 30% of taxable income (ii) a company, 20% of taxable income If amount or property is donated by associate C shall be in the case of – (i) an individual or AOP, 15% of taxable income (ii) a company, 10% of taxable income.	- The fair market value of property shall be determined at the time it is given. - Cash paid will only qualify for tax credit if amount is paid by a crossed cheque.

"A" is the amount of tax payable for the tax year before allowance of any tax credit.
"B" is the person's taxable income for the tax year

S.	Nature	Description	Formula	Limits = C is the lower of	Other considerations
62	Tax credit for Investment in shares and insurance	A resident person other than a company shall be entitled to a tax credit for a tax year **either**: i) if it has acquired new shares offered to public by a public company listed on a stock exchange in Pakistan. The person should be original allottee of the shares, or if it has acquired shares from Privatization Commission of Pakistan; ii) on cost of acquiring sukuks offered to public by a public company listed on a stock exchange in Pakistan. The person should be original allottee of the sukuks iii) in respect of cost of acquiring in a tax year, unit of exchange traded fund offered to public and traded on stock exchange in Pakistan; or iv) for life insurance premium paid to a life insurance company registered by SECP if he is deriving income from salary or business.	(A/B)x C	(a) the cost of acquiring the shares, or sukuks or the contribution or premium paid by the person (b) 20% of the taxable income or (c) Rs. 2,000,000	Where – (a) a tax credit has been allowed for shares purchased; and (b) the person has made disposal of the shares within 24 months of date of acquisition, the tax for the tax year in which shares were disposed of shall be increased by the credit allowed. [Ex. – 5] Further where – a) a tax credit has been allowed for life insurance premium paid and b) the insurance policy is surrendered within 2 years of its acquisition, the tax credit allowed shall be deemed to have been wrongly allowed and the Commissioner shall re-compute the tax payable by the tax payer for the relevant tax year.
62A	Tax credit for investment in health insurance	A resident person other than a company shall be entitled to a tax credit for a tax year for health insurance premium or contribution paid to any insurance company registered by SECP if the person is deriving income from salary or business.	(A/B)x C	(a) the total contribution or premium paid in the tax year; (b) 5% of the taxable income; and (c) Rs. 150,000	

"A" is the amount of tax payable for the tax year before allowance of any tax credit.
"B" is the person's taxable income for the tax year

S.	Nature	Description	Formula	Limits = C is the lower of	Other considerations
63	Contribution to approved pension fund	An eligible person earning income from salary or business shall be allowed a tax credit for premium paid in approved pension fund under the Voluntary Pension System Rules, 2005. "Eligible Person" means an individual Pakistani who holds a valid National Tax Number or Computerized NIC or NIC for Overseas Pakistanis issued by NADRA. "Approved Pension Fund" means Pension Fund approved by SECP under Voluntary Pension System Rules, 2005.	(A/B)x C	(a) the premium paid by the person in the year (b) 20% of the taxable income of the person for relevant tax year. However if he joins the pension fund at the age of 41 years or above he shall be allowed additional contribution of 2% per annum for each year of age exceeding 40 years (upto the 30th June, 2019). However total contribution shall not exceed 30% of the taxable income of previous year.[Ex. – 6]	The transfer by the members of old schemes of their old balance to the new individual pension account shall not qualify for tax credit.

Exam Note:
For tax credit under Sec 63, if tax year 2019 or any of the previous year is given in numerical, then limit of 30% for calculating C will apply otherwise the rule is simple for calculating C i.e. actual contribution or 20% of taxable income whichever is lower.

"A" is the amount of tax payable for the tax year before allowance of any tax credit.
"B" is the person's taxable income for the tax year
[For above sections see Example-4, 5 and 6 on upcoming pages]

Deductible allowance for Profit on debt [Sec. 60C]

(1) Every individual shall be entitled to a deductible allowance for profit or share in rent and share in appreciation for value of house paid in the year on a loan received from a:
- scheduled bank or
- nonbanking finance institution or
- Government or
- the Local Government or
- the Provincial Government or
- statutory body or
- public company listed on a registered stock exchange in Pakistan

The loan should be used for:
- the construction of a new house or
- the acquisition of a house.

(2) The allowance allowed shall be lower of:
(a) profit paid by the person in the year
(b) 50% of taxable income or
(c) Rs. 2,000,000.

(3) An allowance which is not able to be deducted shall not be carried forward to a subsequent year.

Note: If employer provides employee a loan for the construction of a new house or the acquisition of a house and employer falls under the categories mentioned in S. 60 C (1) the employee can claim a deductible allowance under this section.

Example:

Mr. Asim is an employee of ABC, a listed company. He obtained a loan of Rs. 1,600,000 from employer on February 1, 2013 for constructing new house. The interest charged by employer on this loan is 6% per annum. He has provided you following details regarding his salary income per month for TY 2013.

Basic Salary	50,000
House rent allowance	30,000

Calculate taxable income.

Answer:

Income from Salary

Basic Salary	(50,000 x 12)	600,000
House rent allowance	(30,000 x 12)	360,000
Interest benefit on loan	(1,600,000 x (10%-6%) x 5/12)	26,667
Total Income		986,667
Less: Deductible allowance u/s 60C (lower of :)		
- profit paid by employee (1,600,000 x 6% x 5/12) =	40,000	
- 50% of 986,667 = 493,334		
- 2,000,000		(40,000)
Taxable Income		946,667

Deductible allowance for educational expenses [Sec. 60D]

(1) Every individual is entitled to a deductible allowance for tuition fee paid if the taxable income of individual is less than Rs. 1,500,000.

(2) The allowance allowed shall be lower of:
(a) 5% of the total tuition fee paid by the individual in the year;
(b) 25% per cent of the person's taxable income for the year; and
(c) an amount computed by multiplying Rs. 60,000 with number of children of individual.

(3) An allowance which is not able to be deducted shall not be carried forward to a subsequent year.

(4) Allowance shall be allowed to either of the parents on furnishing national tax number (NTN) or name of the educational institution.

(5) The allowance shall not be considered for calculating tax deduction under the head salary.

Tax credit for certain persons [Sec 65F]

(1) Following taxpayers shall be allowed 100% tax credit (including minimum tax and final taxes) upon fulfillment of certain conditions/limitations:

(i) Persons engaged in coal mining projects in Sindh supplying coal to power generation projects;

(ii) A startup (as defined in Clause (62A) of Section 2) which is certified by the Pakistan Software Export Board. Credit will be allowed in the year of startup and for the following two years;

(iii) Persons deriving income from exports of computer software or IT services or IT enabled services up to the period ending on 30 June 2025 if 80% of the export proceeds are brought into Pakistan in foreign exchange through normal banking channel.

(2) Following are the conditions:

(i) Annual return of income has been filed.

(ii) Withholding tax statements for relevant tax year have been filed, if person is withholding agent; and

(iii) Monthly sales tax returns for the tax periods (corresponding to the relevant tax year) have been filed.

Tax credit for specified industrial undertakings [Sec 65G]

(1) A tax credit of 25% of eligible investment amount is allowed to eligible persons in the year of investment. It will be allowed against normal tax payable (including minimum tax and final taxes). Unadjusted amount of tax credit may be carried forward to 2 subsequent tax years.

(2) "Eligible investment" means any investment made in the purchase and installation of new machinery, buildings, equipment, hardware and software except self-created software and used capital goods.

(3) **"Eligible person"** means:

(a) Green field industrial undertaking engaged in:

(i) the manufacture of goods or materials or putting goods or materials to any process which substantially changes their original condition or

(ii) Ship building

The credit will be allowed only if undertaking is incorporated between 30 June 2019 and 30 June 2024 and is not formed by splitting up or reconstitution of undertaking already in existence.

(b) Industrial undertaking set up by the 30th day of June 2023 and engaged in the manufacture of plant, machinery, equipment and items with dedicated use (no multiple use) for generation of renewable energy from sources like solar and wind for a period of 5 years beginning from the date such industrial undertaking is set up.

Greenfield industrial undertaking" means-

(a) a new industrial undertaking which is:

(i) setup on land that is not previously used for any commercial, industrial or manufacturing activity (and is free from constraints imposed by any prior work);

(ii) built without demolishing, revamping, renovating, upgrading, remodeling or modifying any existing structure or plant;

(iii) not formed by the splitting up or reconstitution of an undertaking already in existence

(iv) using any process or technology that has not earlier been used in Pakistan and is approved by the Engineering Development Board; and

(b) approved by the Commissioner

This definition is applicable from July 1, 2019 and onwards.

Tax credit for point of sale machine [Sec 64D]

(1) All Tier 1 retailers are required to integrate with Board's Point of Sale online real time reporting system. A tax credit for POS machines will be allowed to them.

(2) The tax credit will be allowed for the tax year in which the point of sale machine is installed, integrated and configured with the FBR's computerized system, at the lower of:

i. amount actually invested in purchase of point of sale machine; or

ii. Rs. 150,000/ machine.

(3) 'Point of sale machine' is a machine made for processing and recording the sale transactions for goods or services, either in cash or through credit and debit cards or online payments (in an internet enabled environment).

Miscellaneous provisions relating to tax credits [Sec. 65]
Tax credit allowed from section 61-63 shall not be refunded, carried forward to a subsequent tax year, or carried back to a preceding tax year.

OTHER TAX CREDIT
Full Time Teacher Allowance
The tax payable by:
- a full time teacher or a researcher
- who is employed in a non-profit education or research institution duly recognized by:
  - Higher Education Commission,
  - a Board of Education or
  - a University recognized by the Higher Education Commission,

  including government research institution, shall be reduced by 25% of tax payable on his "INCOME FROM SALARY".

  This clause shall not apply to teachers of medical profession who derive income from private medical practice or who receive share of consideration received from patients.

Note for students: 25% reduction will always be calculated using salaried case Table. (i.e. Table 2 in CH-4).

Question
Mr. B is a fulltime teacher of a recognised university. Following data relates to incomes earned by him during the tax year 2013.

Annual taxable salary income	660,000
Capital gains	100,000
Age on 1st July, 2012 is 58 years.	

Required: Calculate tax liability for the tax year 2013.

Solution

Taxable income from salary	660,000
Capital Gain	100,000
Taxable income	760,000
Tax liability [(760,000 – 600,000) = 160,000 x 5%] (Table 2)	8,000
Tax reduction on salary [(660,000 – 600,000) = 60,000 x 5%] x 25%	(750)
Tax payable to Government	7,250

2. Foreign tax credit [Sec. 103]
(1) Where a resident taxpayer derives taxable foreign source income on which foreign income tax is paid, a tax credit will be allowed at lower of –
  (a) the foreign income tax paid; or
  (b) the Pakistan tax payable in respect of the income.
  "foreign income tax" includes a foreign withholding tax
(2) The Pakistan tax shall be calculated by multiplying the average rate of Pakistan income tax to the net foreign-source income.
  "average rate of Pakistan income tax" is the % that Pakistani income tax is of the taxable income for the year;
  "net foreign-source income" means the total chargeable foreign-source income less deductions allowed that relate exclusively and can reasonably be allocated to the derivation of the foreign-source income.
(3) Where a taxpayer has foreign income under more than one head, calculation for each head of income shall be separately made. [See Example-2 below]
(4) For above provision, speculation business shall be treated as a separate head of income.
(5) Following is the order for tax credits:
  (a) foreign tax credit (allowed under section 103); then
  (b) tax credit allowed on charitable donations, tax credit for investment in shares and insurance, tax credit for investment in health insurance and tax credit on contribution to approved pension fund (u/s 61-63); and then
  (c) tax credit for advance tax paid (u/s 147).
  [See Example-3 below]

(6) The foreign tax credit shall not be:
- refunded,
- carried back to the preceding tax year, or
- carried forward to the following tax year.

(7) A credit shall be allowed only if the foreign income tax is paid within 2 years after the end of the tax year in which the foreign income was derived.

Practically speaking foreign tax credit will be allowed in the year in which foreign source income was earned and if it is not paid within the above mentioned time the credit will be added back in the tax liability.

Example

Mr. Umer has earned income from property in Canada on which he has paid foreign income tax. What is the tax treatment?

Answer

He will be allowed a tax credit at lower of
- Foreign tax paid
- the Pakistan tax payable in respect of the income.

Small and Medium Enterprises [Sec 2(59A) read with 14TH Schedule]

Definition- Small and medium enterprise

A person who is engaged in manufacturing and his business turnover in a tax year does not exceed Rs. 250 million. If annual turnover exceeds Rs. 250 million, it shall not qualify as small and medium enterprise in the tax year in which it exceeds or any subsequent tax year.

Definition- Manufacturer

"Manufacturer" means a person who is engaged in production or manufacturing of goods, which includes-:

(i) any process in which an article singly or in combination with other articles, material, components, is either converted into another distinct article or product is so changed, transferred, or reshaped that it becomes capable of being put to use differently or distinctly; or

(ii) a process of assembling, mixing, cutting or preparation of goods in any other manner

SME-Taxation

Small and Medium Enterprise Scheme would be effective from TY 2021 and onwards.

1. Registration

Small and medium enterprise shall be required to be registered with FBR on IRIS portal or it may register itself with Small and Medium Enterprises Development Authority (on its SME registration portal).

2. Categories and tax rates - Taxation under Normal Tax Regime

The rate of tax on the taxable income of a small and medium enterprise is as follows:

Turnover	Tax rate
Where annual business turnover does not exceed Rs. 100 million	7.5%
Where annual business turnover exceed Rs. 100 million but does not exceed Rs. 250 million	15%

SMEs opting NTR may be selected for audit through risk based parametric computer balloting (under S.214C). However it will be selected only if tax to turnover ratio is below:

- 0.25% (where turnover is less than PKR 100 million) or
- 0.5% (where turnover is more than 100 million but less than PKR 250 million)

Further cases to be selected here for audit would not exceed 5% of total population of such SMEs.

Note:

SME has been provided with an option be taxed under FTR. If option is not exercised, the income would be taxable under NTR;

3. Minimum tax

Section 113 will not apply on SMEs.

5. Provisions of Ordinance

All other provisions of the Ordinance (including tax withholding) would be applicable on SME.

Whether this scheme applicable on traders and service Providers- It is applicable on manufacturer only and does not apply on traders/service providers etc.

Women Enterprise and its taxation [Clause 19 Part III of Second Schedule]

Definition

Woman enterprise means a start-up established on or after first day of July 2021 as:

- sole proprietorship concern owned by a woman or
- an AOP all of whose members are women or
- a company whose 100% shareholding is held or owned by women

Taxation

Tax payable by women enterprise on profits and gains of business shall be reduced by 25%. This benefit will not be available to business that is formed by the transfer or reconstitution or splitting up of an existing business.

Example-1

Mr. Ubaid has disclosed the following information.

Income from business	700,000
Income from capital gain	200,000
Donation to non-profit organization	30,000
Zakat	281,900

Solution

Income from business	700,000
Income from capital gain	200,000
Total Income	900,000
Less: Zakat	(281,900)
Taxable income	618,100
Tax liability {10,000 + (10% x 18,100)} (Table 1)	11,810
Less: Tax credit u/s 61 (11,810/618,100 x 30,000)	(573)
(C is lower of: 30,000 or 30% of 618,100)	
	11,237

Example-2

Following data relates to net incomes earned by Mr. Umer Ali during tax year 2013

	Rupees
Foreign source income from business	100,000
Foreign tax on income from business	10,000
Foreign source income from other sources	250,000
Foreign tax on income from other sources	80,000
Pakistan source income from business	700,000
Pakistan source income from salary	600,000

Required: Compute the tax liability?

Solution

Pakistan source income		
- Salary income		600,000
- Business income		700,000
Foreign source income		
- Income from other source		250,000
- Business income		100,000
Taxable income		1,650,000
Computation of tax liability		
Tax liability {70,000 + (15% x 450,000)} (Table 1)		137,500
Less: Foreign tax credit on income from business:		
Lower of:		
a) Pakistan average rate of tax (137,500/1,650,000 x 100,000)	8,333	
b) Foreign income tax paid	10,000	(8,333)
Less: Foreign tax credit on income from other sources:		
Lower of:		
a) Pakistan average rate of tax (137,500/1,650,000 x 250,000)	20,833	
b) Foreign income tax paid	80,000	(20,833)
Payable to Government		108,334

Example-3

Mr. Atif has disclosed the following information for TY 2010.

Income from business – Pakistan	400,000
Income from business – Ethiopia	500,000
Income from capital gain – Pakistan	350,000
Income from capital gain – China	450,000

Foreign taxes paid on:		
- Business (Ethiopia)		40,000
- Capital gain (China)		250,000
Charitable Donation made to approved non-profit organization		10,000
Investment made in new shares of a listed company		15,000

Required: Calculate tax liability?

Solution

Income from business – Pakistan		400,000
Income from business – Ethiopia		500,000
Income from capital gain – Pakistan		350,000
Income from capital gain – China		450,000
		1,700,000
Tax liability {70,000 + (15% x 500,000)} (Table 1)		145,000
Less: Tax credit on foreign source income:		
- Business income	(W-1)	(40,000)
- Capital Gain income	(W-2)	(38,382)
		66,618
Less: Tax credit u/s 61 (66,618/1,700,000 x 10,000) (C is lower of: 10,000 or 30% of 1,700,000)		(392)
Less: Tax credit u/s 62 (66,618/1,700,000 x 15,000) (C is lower of: 15,000 or 20% of 1,700,000 or 2,000,000)		(588)
Tax payable to Government		65,638

(W-1)

Tax Credit on foreign source business income

Lower of:			
Actual foreign income tax paid		40,000	
Average rate	(145,000/1,700,000 x 500,000)	42,647	40,000

(W-2)

Tax Credit on foreign source capital gain income

Lower of:			
Actual foreign income tax paid		250,000	
Average rate	(145,000/1,700,000 x 450,000)	38,382	38,382

Example-4

Mr. Yasir has disclosed total income of Rs. 2,200,000 for TY 2013 and paid Zakat of Rs. 200,000. He has further disclosed the following:-

- He has made donation of Rs. 50,000 to non-profit organization through cross cheque.
- He purchased shares of a new company listed on a registered SE (Stock Exchange) in Pakistan for Rs. 90,000. These were purchased on 13-7-2012.
- He contributed Rs. 70,000 in an approved pension fund.
- He paid interest on house loan amounting to Rs. 120,000.

Required:

Calculate tax liability for TY 2013?

Solution

Total income	2,200,000
Less: Zakat	(200,000)
	2,000,000
Less: Deductible allowance on profit on debt Lower of: 120,000 , 50% of 2,000,000 or 2,000,000	(120,000)
Taxable income	1,880,000
Tax liability {70,000 + (15% x 680,000)} (Table 1)	172,000

Less:	Tax credit		
	u/s 61	(W-1)	(4,574)
	u/s 62	(W-2)	(8,234)
	u/s 63	(W-3)	(6,404)
			(19,212)
Payable to Government			152,788

Workings

1. **u/s 61**

A/B x C = 172,000/1,880,000 x 50,000 = 4,574

C is lower of (50,000 or 30% of 1,880,000)

2. **u/s 62**

A/B x C = 172,000/1,880,000 x 90,000 = 8,234

C is lower of (90,000 or 20% of 1,880,000 or 2,000,000)

3. **u/s 63**

A/B x C = 172,000/1,880,000 x 70,000 = 6,404

C is lower of (70,000 or 20% of 1,880,000)

Example-5

Continuing from previous question Mr. Yasir has disclosed taxable income of Rs. 2,200,000 for TY 2014. He also informed that he has disposed of the shares purchased in TY 2013 on 13-6-2014. When these were acquired a credit of Rs. 8,234 was allowed in TY 2013.

Required:

Calculate tax liability for TY 2014?

Solution

Taxable income	2,200,000
Tax liability {70,000 + (15% x 1,000,000)} (Table 1)	220,000
Add: Credit disallowed	8,234
Payable to government	228,234

Example-6

Mr. Anzah has disclosed taxable income of Rs. 1,800,000 for TY 2017. He also informed you that he joined the pension fund at the age of 43 years in TY 2017 by paying Rs. 490,000 as contribution.

His taxable income for TY 2016 is Rs. 900,000.

Required:

Calculate his tax liability.

Solution

Taxable income	1,800,000
Tax liability {70,000 + (15% x 600,000)} (Table 1)	160,000
Less: Tax credit u/s 63 (W-1)	(24,000)
Tax payable	136,000

(W-1)

A/B x C = 160,000/1,800,000 x 270,000 = 24,000

C is lower of

- 490,000
- 26% of taxable income of current year
  = 1,800,000 x 26% = 468,000
- 30% of taxable income of previous year
  = 900,000 x 30% = 270,000

ICAP PAST PAPER QUESTIONS

Question-1

Mr. Hamza intends to donate Rs. 5 million in cash to the following institutions:

- An institution whose name is listed in the 13th Schedule to the Income Tax Ordinance, 2001.
- A nonprofit organization working for the promotion of education in rural areas of Pakistan

Explain the impact of the above donations on the tax liability of Mr. Hamza. (4)

(Q.4 (a) March 2007)

Question-2

During the tax year 2007, Mr. Yahya, a resident person, derived an income of Rs. 1,500,000 from his business in Pakistan. He has also earned an amount of US$ 30,000 from his business in a foreign country on which he paid income tax to tax authorities of that country, amounting to US$ 10,500. Compute the tax liability of Mr. Yahya for the tax year 2007. **Note:** US$ 1 = Pak Rupees 60 (4)

(Q.4 (b) September 2007)

Question-3

Mr. Zulqarnain intends to make donations to certain charitable institutions. You are required to advise him on the following:

i) The types of institutions to whom the donation(s) would entitle him for tax credit.

ii) The method of calculation of tax credit

(8)(Q.5 (a) March 2008)

Question-4

Mr. Bukhari is a resident person and owns a property abroad. During the year, he received rent amounting to Rs.3 million from that property. The tax on rental income has been duly paid abroad and there is no tax treaty between Pakistan and the country in which the property is situated.

Explain the tax treatment of rental income received by Mr. Bukhari in Pakistan. (3)

(Q.4 (a) March 2009)

Question-5

State the provisions of Income Tax Ordinance, 2001 pertaining to foreign tax credit available to a resident taxpayer.

(6) (Q.2 (b) September 2009), (Q.3 (c) September 2012)

Question-6

Mr. Qamar intends to donate an amount of Rs. 10 million to certain educational and welfare institutions. In your capacity as his tax consultant, explain the tax relief which may be available in respect of such donation and the conditions he must fulfill to avail such relief. (9)

(Q.2 March 2010)

Question-7

Mr. Faisal is a resident taxpayer and has been providing consultancy services to local and foreign clients since 2003. A friend has informed him that under the Income Tax Ordinance, 2001 he can claim a tax credit against any foreign income tax paid by him on his foreign source income.

Required: Explain the provisions of the Income Tax Ordinance, 2001 pertaining to foreign tax credit available to a resident taxpayer. (6)

(Q.3 (b) September 2010)

Question-8

Mr. Ashraf made the following donations during the income year 2015-2016:

(a) Rs. 200,000 in cash to a relief fund sponsored by the Government.

(b) Personal car to an institution approved as non-profit organisation. This car was purchased by Mr. Ashraf four years ago at the cost of Rs. 800,000. The fair market value is Rs. 600,000.

(c) Medicines to a private hospital purchased at the total cost of Rs. 100,000.

Required: Explain the tax credits for donation which may be claimed by him.

Question-9

Determine the amount of deductible allowance that a resident individual can claim on account of education expenses, if his taxable income for the year was Rs. 800,000 and he paid monthly fee of Rs. 6,000 per child for his three children. (02)

(Q.2 (c) September 2017)

Question-10

Differentiate between deductible allowances and admissible deductions. Give **three** examples of each. (06)

(Q.3(b) Sep. 2020)

ICAP PAST PAPER SOLUTIONS

Answer-1

Donation to an institution whose name is listed in the 13th Schedule and to a non-profit organization

Mr. Hamza shall be entitled to a tax credit in respect of any sum paid in the tax year as a donation to any non-profit organization.

Donation should be through cross cheque.

The amount of Mr. Hamza's tax credit allowed for the tax year shall be computed according to the following formula, namely:-

$(A / B) \times C$

A is the amount of tax assessed to him for the tax year before allowance of any tax credit

B is the taxable income for the tax year; and

C is the lesser of –

(A) the total amount of donations

(B) thirty percent of taxable income of the person for the year

If amount or property is donated by an associate C shall be 15% of taxable income.

Answer-2

Income from business – Pakistan source			1,500,000
Income from business – Foreign source (30,000 x 60)			1,800,000
Taxable Income			3,300,000
Tax liability {370,000 + (25% x 300,000)} (Table 1)			445,000
Less: Foreign tax credit, Lower of:			
- Actual Foreign tax paid	(10,500 x 60)	630,000	
- Pakistani tax payable in respect of FSI	(445,000/3,300,000 x 1,800,000)	242,727	(242,727)
			202,273

Answer-3

Mr. Zulqarnain shall be entitled to a tax credit in respect of any sum paid in the tax year as a donation to: [S.61]

(i) Any board of education or any university in Pakistan established under a Federal or a Provincial law;

(ii) Any educational institution hospital or relief fund established to run in Pakistan by Federal Government or a Provincial Government or a local authority; or

(iii) any non-profit organization or any persons eligible for tax credit under section 100C; and

(iv) entities, organizations and funds mentioned in 13th Schedule of the Ordinance.

The amount of Mr. Zulqarnain's tax credit allowed for the tax year shall be computed according to the following formula, namely:-

$$(A / B) \times C$$

A is the amount of tax assessed to him for the tax year before allowance of any tax credit

B is his taxable income for the tax year; and

C is the lower of –

(i) the total amount of donations

(ii) thirty per cent of the taxable income of the individual for the year

If amount or property is donated by an associate C shall be 15% of taxable income.

The benefit of a cash donation shall be allowed only if it is paid by a crossed cheque.

Answer-4

Rental income earned by Mr. Bukhari is foreign source income. As he has paid the foreign tax so he will be allowed a credit in respect of foreign tax paid. [S.103]

The credit will be calculated as lower of:

- Income tax paid abroad; and
- Pakistan tax payable on foreign-sourced income.

Answer-5

Same as Answer-7

Answer-6

Donation specified **u/s 61** of Income Tax Ordinance, 2001

Mr. Qamar shall be entitled to a tax credit in respect of any sum paid in the tax year as a donation to:

(i) Any board of education or any university in Pakistan established under a Federal or a Provincial law;

(ii) Any educational institution hospital or relief fund established to run in Pakistan by Federal Government or a Provincial Government or a local authority; or

(iii) any non-profit organization or any persons eligible for tax credit under section 100C; and

(iv) entities, organizations and funds mentioned in 13th Schedule of the Ordinance.

The amount of Mr. Qamar's tax credit allowed for the tax year shall be computed according to the following formula, namely:-

$$(A / B) \times C$$

A is the amount of tax assessed to him for the tax year before allowance of any tax credit

B is his taxable income for the tax year; and

C is the lesser of –

- (i) the total amount of donations
- (ii) 30 % of the taxable income of the individual for the year

If amount is donated by an associate C shall be 15% of taxable income.

The benefit of a cash donation shall be allowed only if it is paid by a crossed cheque.

Answer-7

S.103

Answer-8

Mr. Ashraf

Sub: Tax credit for Donations u/s 61 of the Income Tax Ordinance 2001

Dear Sir,

We explain as under allowance for donation, which you can claim under the provisions of section 61 of the Income Tax Ordinance, 2001:

(a) Under section 61(4), a taxpayer is entitled to a tax credit in respect of any sum paid through crossed cheque. As in your case the payment has been made in cash, you cannot claim the tax credit on the donation stated above.

(b) Donations given to an approved non-profit organization in kind are admissible under section 61 of the Income Tax Ordinance, 2001.

(c) Medicine to a private hospital purchased at the total cost of Rs. 100,000. Donation to private hospital is not admissible under section 61 of the Income Tax Ordinance, 2001 and tax credit on donations is only admissible where the said donation is paid to the non-profit organization.

Section 61 of the income tax ordinance, 2001 also requires that the aggregate amount of the donation must not be in excess of 30% of the taxable income in the case of an individual assesse.

If amount or property is donated by an associate C shall be 15% of taxable income.

Answer-9

Deductible allowance for educational expenses shall be allowed at lower of;

a. 5% of total tuition fee paid by the individual in the year which is Rs. 10,800 (Rs. 6,000 x 3 children x 12 months x 5%)

b. 25% of the person's taxable income for the year which is Rs. 200,000 (Rs. 800,000 x 25%)

c. amount computed by multiplying Rs. 60,000 with the number of children of individual which is Rs. 180,000. (Rs. 60,000 x 3 children)

Thus the amount of deductible allowance that he can be claimed is Rs. 10,800.

Answer-10

An **admissible deduction** is specific to a particular head of income and is deducted from income under that head. Where total deduction allowed to a person for a tax year under a head of income exceed the total amounts chargeable to tax, the person shall be treated as sustaining a loss for that head. [S. 11 (3)]

Some **examples** of admissible deductions are:

- Tax depreciation
- Initial allowance
- Salaries
- Rent expense
- Repair expense

A **deductible allowance** is deducted from the total income. An allowance for a tax year that is not fully deducted shall not be carried forward. **Examples** of deductible allowance are:

- Zakat
- Workers welfare fund
- Workers participation fund
- Deductible allowance for Profit on debt [S.60 C]
- Deductible allowance for educational expenses [S.60 D]

LECTURE NOTES

Question-1

Mr. Tanveer was working as a Marketing Head with Consumer Products Ltd (CPL) Private company at following emoluments:

(i) Basic Salary Rs.100,000 per month

(ii) Utility allowance Rs.40,000 per month

a) In addition to the above cash emoluments, he was provided with a Honda Civic car, exclusively for official use. The cost of car to the Company was Rs.1,000,000. He got retired on March 31, 2021. As per company's policy, the car was sold to him during the year at the WDV of Rs. 200,000 whereas the FMV of the same at the time of sale was Rs.300,000.

b) He was provided with furnished accommodation for which CPL Pakistan Ltd paid a rent of Rs.25,000 per month.

c) On retirement he received Rs.300,000 from gratuity scheme approved by FBR. He also received Rs.600,000 from un-appproved commutation of pension. Both payments are credited to his bank account in foreign country.

d) Loan of Rs.700,000 was given to him on 1 August 2015 at 6% per annum. It was repaid on retirement.

e) During the year, Tanveer recorded gain on disposal of shares. Details are as under:

Name of investee company	Sold on	Purchased On	Gain/(loss) on disposal (Rs.)
Moon Limited - a listed company	15 Sep 2020	1 Jan 2017	(700,000)
Planet Limited - a listed company	1 Feb 2021	1 Jan 2018	1,250,000

f) Zakat of Rs. 50,000 was paid as per Zakat & Usher Ordinance.

g) Tanveer acquired 1,500 shares of a listed company from Privatization Commission of Pakistan at a price of Rs.60 per share on 15 January 2021.

Required:

Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute the taxable income and net tax payable by or refundable to Tanveer for the year ended 30 June 2021.

INCOME FROM SALARY

7

1. Definitions [Sec. 2]
2. Salary [Sec. 12]
3. Value of perquisites [Sec. 13]
4. Self hiring of property [S. 15(5)]
5. Employee share schemes [Sec. 14]
6. Foreign source salary of resident individuals [Sec. 102]
7. [Section 51(2)]
8. Important Exemptions in Second Schedule Part 1
9. Taxation of Provident Fund

CHAPTER 7

INCOME FROM SALARY

Definitions [Sec. 2]

(20) "employee" means any individual engaged in employment;

(21) "employer" means any person who engages and remunerates an employee;

(22) "employment" includes –

(a) a directorship or other office involved in the management of a company;

(b) a position which gives the employee a fixed or ascertainable remuneration; or

(c) the holding or acting in any public office;

a) Any remuneration paid to the directors for the purposes of rendering management services to the company will fall under the definition of employment.

b) It includes a person which is remunerated on the basis of sales made by him.

c) Public offices refers to MNAs and MPAs.

Note:

It's important that master servant relationship exists between the person who is using the service and the person who is rendering the service. If it does not exist, it will not be treated as an employment, rather it will be considered as independent service rendered to the person who has hired him.

Example 1

The relationship between RISE School of accountancy and permanent faculty member is an employment relationship, while the relation between RISE School of accountancy and visiting faculty member is not an employment relationship.

The remuneration paid to the permanent faculty member is fixed irrespective of number of lectures taught by him, while the remuneration paid to the visiting faculty member varies with the number of lectures taught by him.

Example 2

ABC company is in the business of repairing computers. The company has engaged Mr. Aslam on a monthly salary of Rs. 30,000 and his job is to repair the computers of the company. One of the computers was damaged badly due to some mishandling. The company called Mr. Babar from Hafeez centre who charged the company Rs. 200/ hour for three hours worked by him.

The relationship between ABC company and Mr. Aslam is an employment relationship, while the relationship between ABC company and Mr. Babar is not an employment relationship because he is providing services in an independent capacity.

Salary [Sec. 12]

(1) Any salary received by an employee (other than exempt salary), shall be chargeable under the head "Salary".

Salary is taxable on receipt basis and not on accrual basis.

Example

Mr. Syed Aamir Ali is working as CFO in a company. He joined the company on August 1, 2010. In TY 2011 his salary per month was Rs. 30,000 and in TY 2012 his salary per month was Rs. 40,000. As per the policy the company pays salary to the employee on the 2nd day after the end of each month. Calculate his salary income for TY 2011 and 2012 on the basis of available information.

Answer

Salary Income for TY 2011

(10 months x Rs 30,000/month) = Rs. 300,000

(First receipt is in the month of September)

Salary Income for TY 2012

(1 months x Rs 30,000/month + 11 month x Rs 40,000/ month) = Rs. 470,000

(First receipt is in the month of July (TY 2012) which represents June 2011 salary)

When a salary is treated to be received

A person shall be treated as having received an amount, benefit, or perquisite if it is –

a) actually received by the person;

b) applied on behalf of the person, at the instruction of the person or under any law; or

c) Made available to the person. **[Sec 69]**

a) Mr. A has received the salary in cash.

b) Applied on behalf

Employer deducts Rs. 2,000 per month from employee's salary and deposits the same amount in a provident fund maintained on behalf of the employee.

At the instruction of person

Mr. Sheikh is working as an employee in a company. He has instructed to pay Rs. 10,000 as club membership fee

Under any law

Mr. Amjad is working as an employee in company on a monthly salary of Rs. 40,000. He has made default in the payment of property tax amounting to Rs. 25,000.The Court passed an order to the company to deduct Rs 25,000 from his salary and deposit the same amount in Government treasury. When the employer will follow the instructions, the employee will be treated to have received the salary.

c) Made available to the person

Employer has handed over the cheque to the employee. Employer has provided to employee the benefit in kind instead of cash.

Chairs given to an employee instead of salary (benefit in kind).

In the month of June 2008 PTCL recorded salary payable in its financial records of an employee Mr. Shafqat. The salary will be paid in the month of July 2008. Is the salary will be assumed as received in June 2008?

Conclusion

No sum is received in June 2008.

(2) Salary received by an employee from any employment, whether of a revenue or capital nature, including –

Capital receipts

An example of capital receipt is golden hand shake receipt at the time of retirement.

a) any pay, wages or remuneration provided to an employee, including leave pay, payment in lieu of leave, overtime, bonus, commission, fees, gratuity or work condition supplements (such as for unpleasant or dangerous working conditions):

Gratuity

It will be discussed in upcoming paras.

Work condition supplements

A is working in a company which produces some medicines. During the process of manufacturing some liquid evaporates which is dangerous for the health of employees. In compensation for working in such dangerous conditions company pays Rs 2,000 per month to employee. It will be Salary income of Mr. A.

b) any perquisite

Perquisites will be discussed in section 13.

c) any allowance provided by an employer including a cost of living, subsistence, rent, utilities, education, entertainment or travel allowance, excluding allowances solely expended for performing official duties;

Explanation: Any allowance solely expended in the performance of employee's duty does not include:

1. allowance which is paid in monthly salary on fixed basis or percentage of salary or
2. allowance which is not wholly, exclusively, necessarily or actually spent on behalf of the employer;

d) an expense of an employee that is paid or reimbursed by the employer, other than reimbursements for performing official duties;

EXPLANATION (c) AND (d):

- As a simple rule all cash allowances and reimbursement of expenses for any purpose other than the performance of official duties are taxable as salary.
- All of the expenses incurred necessarily to meet the official duty are not chargeable to tax.

Example

Mr. Bilal is working as an executive in a beverages company. He has provided you with the following details in order to calculate his taxable income.

Basic salary per annum	240,000
Dearness allowance per annum	48,000
House rent allowance per annum	72,000

During the year he was sent by the company to Nepal for the purpose of some training. Travelling and lodging cost of Rs. 300,000 was reimbursed by the company.
During the year he also bought some magazines due to his interest in cricket. The company reimbursed Rs. 3,000 against this on production of actual bills. During the year the company has also paid his home insurance expense amounting to Rs. 10,000. You are required to calculate his taxable income.

Solution

Basic salary	240,000
Dearness allowance	48,000
House rent allowance	72,000
Reimbursement for magazines	3,000
Insurance expense of home	10,000
Taxable Income	**373,000**

e) the amount of any profits in lieu of, or in addition to, salary including any amount received –
   i) by a person for agreeing to enter into an employment relationship;
   ii) by a person for agreeing to any conditions of employment or any changes to those conditions;
   iii) on termination of employment, including compensation for redundancy or loss of employment and golden handshake payments;
   iv) from a provident or other fund, if it is not a repayment of contribution by the employee [It will be discussed at the end of this document]; and
   v) by a person for agreeing to a restrictive covenant for any past, present or prospective employment;

Example (e):
Mr.Arif is a CFO of Multi Billion(MBL) Ltd., which is a leading commercial bank. A new company, Pak Japan Ltd. (PJL) has recently established with the strategy of acquiring top executives from the market. PJL has approached Mr. Arif to work as a CFO. PJL offers him a handsome salary along with following benefits:
- Rs. 200,000 for agreeing to enter into contract of employment with PJL and leaving MBL [example of (i)]
- Rs. 1,200,000 for condition that Mr. Arif will not enter into contract with any other company for a period of 5 years. [example of (v)]
- Other terms:
  - During the term of employment, Mr. Arif will not be posted abroad. If Mr. Arif is posted abroad, he will be paid compensation. [example of (ii)]
  - If due to recession, PJL intends to layoff the employees, each employee will have an option to continue employment or opt voluntary retirement in consideration of some termination benefit. [example of (iii)]

All such amounts shall be taxable under the head "Income from Salary"

f) any pension, annuity and
g) Any amount chargeable u/s 14.

(3) Tax free salary to employee
Where an employer agrees to pay tax on employee's salary, the employee's salary income shall be grossed up by the tax payable by employer.

Note: Requirement in all questions is to calculate the tax liability.

Question-1

Mr. A provided following:

Basic Salary	340,000/m
House Rent allowance	130,000/m

Tax on salary is to be borne by employer.

Answer: Income from Salary

Basic Salary	(340,000 x 12)	4,080,000
House Rent allowance	(130,000 x 12)	1,560,000
		5,640,000
Add: Tax Benefit (W)		1,038,359
Salary Income		6,678,359

Tax liability (Table 2)	(670,000 + 22.5% of 1,678,359)		1,047,631
Less: Tax already paid by the employer			(1,038,359)
Tax payable with return			*9,272

*(Ideally it should be Rs. 0 but we have stopped calculation at Step 3 so it is not zero.)

Working:

Step 1	Salary Income		5,640,000	
	Tax on above (Table 2)	(670,000 + 22.5% of 640,000)		814,000
Step 2	Salary Income	(5,640,000 + 814,000)	6,454,000	
	Tax on above (Table 2)	(670,000 + 22.5% of 1,454,000)		997,150
Step 3	Salary Income	(5,640,000 + 997,150)	6,637,150	
	Tax on above (Table 2)	(670,000 + 22.5% of 1,637,150)		1,038,359

Question-2

Mr. A provided following:

Basic Salary	340,000/m
House Rent allowance	130,000/m
Capital Gain	600,000

Tax on salary is to be borne by employer.

Answer

Income from salary		
Basic Salary	(340,000 x 12)	4,080,000
House Rent allowance	(130,000 x 12)	1,560,000
		5,640,000
Add: Tax Benefit (W)		1,038,359
Salary Income		6,678,359
Income from Capital Gain		600,000
Taxable Income		7,278,359

Tax liability (Table 2)	(670,000 + 22.5% of 2,278,359)	1,182,631
Less: Tax already paid by the employer		(1,038,359)
Tax payable with return		144,272

Working:

Step 1	Salary Income		5,640,000	
	Tax on above (Table 2)	(670,000 + 22.5% of 640,000)		814,000
Step 2	Salary Income	(5,640,000 + 814,000)	6,454,000	
	Tax on above (Table 2)	(670,000 + 22.5% of 1,454,000)		997,150
Step 3	Salary Income	(5,640,000 + 997,150)	6,637,150	
	Tax on above (Table 2)	(670,000 + 22.5% of 1,637,150)		1,038,359

Question-3

Mr. B provided following detail:

Basic Salary	40,000/m
House Rent allowance	30,000/m

Tax of Rs. 500 will be borne by employer.

Answer:

Basic Salary		480,000
House Rent allowance		360,000
		840,000
Add: Tax Benefit		500
Tax able Income		840,500
Tax liability (Table 2)	(5% x 240,500)	12,025

Less: Tax paid by employer	(500)
Tax payable with return	11,525

Question-4

Mr. A provided following data:

Basic Salary	90,000/m
House Rent allowance	60,000/m
Bonus paid	200,000

Employer will himself pay tax on employee salary.

Answer

Basic Salary	(90,000 x 12)		1,080,000
House Rent allowance	(60,000 x 12)		720,000
Bonus			200,000
			2,000,000
Tax Benefit (W)			140,700
Taxable Income			2,140,700
Tax liability (Table 2)	(90,000 + 15% x 340,700)		141,105
Less: Tax already paid by employer			(140,700)
			405

Working:

Step 1	Salary Income		2,000,000	
	Tax on above (Table 2)	(90,000 + 15% x 200,000)		120,000
Step 2	Salary Income	(2,000,000 + 120,000)	2,120,000	
	Tax on above (Table 2)	(90,000 + 15% x 320,000)		138,000
Step 3	Salary Income	(2,000,000 + 138,000)	2,138,000	
	Tax on above (Table 2)	(90,000 + 15% x 338,000)		140,700

(4) No deduction shall be allowed for an expense paid by an employee under the head "Salary".

(5) An amount shall be treated as received by an employee if it is paid:

a) By the employee's employer, an associate of the employer, or a third party under an arrangement with the employer;
b) by a past or prospective employer; or
c) to the employee or an associate of the employee or a third party under an agreement with the employee.

(6) An employee who has received an amount on termination of employment, including compensation for redundancy or loss of employment and golden handshake [as per S.12 (2) (e) (iii)] may, by notice to Commissioner, elect for the amount to be taxed at following rate:–

A/B%

A is the tax paid by the employee on the employee's taxable income for 3 preceding tax years and
B is the employee's taxable income for 3 preceding tax years.

The above option can be exercised by due date of furnishing return of income. Commissioner may allow a longer period. [S.12 (8)]

Note: If there is a loss, say in one of the 3 preceding tax years then we will take the average of remaining 2 years.

Question

Mr. Azhar is an employee of ABC company. He has provided you with the following details for TY 2011. His basic salary is Rs.40,000/month. Dearness allowance is Rs. 2,000/ month and house rent allowance is Rs. 20,000/month. He retired on April 30, 2011. Golden Handshake payment received on retirement amounted to Rs. 950,000

Details of preceding four tax years taxable income and tax liability is as follows. Calculate his taxable income and tax liability.

Tax Year	Taxable Income	Tax liability
2007	600,000	10,000
2008	1,000,000	48,000
2009	800,000	24,000
2010	900,000	36,000

Answer

Treating Golden hand shake receipt in normal way

Basic salary	(40,000 x10)	400,000
Dearness allowance	(2,000 x10)	20,000
House rent allowance	(20,000 x10)	200,000
Golden handshake		950,000
Taxable income		1,570,000
Tax liability (Table 2)	(30,000 + 10% x 370,000)	67,000

Treating Golden hand shake receipt as a separate block

Basic salary	(40,000 x10)	400,000
Dearness allowance	(2,000 x10)	20,000
House rent allowance	(20,000 x10)	200,000
Golden handshake		950,000
Total income		1,570,000
Less: Golden handshake separate block		(950,000)
Taxable income – taxable under NTR		620,000

Tax liability

Tax liability on salary income other than golden hand shake	(20,000 x 5%)	1,000
Add: Tax on Golden hand shake	(950,000 x (W) 4%)	38,000
		39,000

As the tax liability is lower in the case the golden shake is treated as a separate block, therefore this option is feasible for taxpayer.

(Working)

Tax Year	Taxable Income	Tax liability
2008	1,000,000	48,000
2009	800,000	24,000
2010	900,000	36,000
	2,700,000	**108,000**
Average rate (108,000/2,700,000)		4.00%

(7) Where –

a) any salary is paid to an employee in arrears; and

b) because of this employee's income is charged at higher rate as compared to the rate that was applicable if the salary was paid in the year he rendered the services, he may, give notice to the Commissioner, and elect the rate applicable in the year in which he earned salary.

The above option can be exercised by due date of furnishing return of income. Commissioner may allow a longer period. [S.12 (8)]

Question

Mr. Shoaib has disclosed the following information.

	TY 2009	TY 2010
Salary / Month	30,000	50,000

Due to some disturbance in city the salary of last 4 months of TY 2009 was given in TY 2010 and all other payments were made on time.

You should assume the following slab rates:

0 to 200,000	0%
200,001 – 400,000	1%
400,001 – 650,000	2%
650,001 – 900,000	6%

Answer

Option 1(On received basis)

TY 2009		
Taxable Income	(30,000 x 8)	240,000
Tax Liability	(240,000 x 1%)	2,400
TY 2010		
Taxable Income	(30,000 x 4) + (50,000 x 12)	720,000
Tax Liability	(720,000 x 6%)	43,200

Option 2(On accrual basis)

TY 2009		
Taxable Income	(30,000 x 12)	360,000
Tax liability	(360,000 x 1%)	3,600
TY 2010		
Taxable Income	(50,000 x 12)	600,000
Tax liability	(600,000 x 2%)	12,000
Tax Payable:		
- Option 1	(2,400 + 43,200)	45,600
- Option 2	(3,600 + 12,000)	15,600

Therefore option 2 is feasible

Value of perquisites [Sec. 13]

(3) Rule 5-Income Tax Rules 2002

Following will be added in the income if employer has provided employee a motor vehicle in a tax year:

Partly for personal and partly for official use	5% of (a) the cost to the employer for acquiring the motor vehicle; or (b) The fair market value of the motor vehicle at the commencement of the lease, if it is taken on lease.
For personal use only	10% of (a) the cost to the employer for acquiring the motor vehicle; or (b) The fair market value of the motor vehicle at the commencement of the lease, if it is taken on lease.
For official use	0%

Running and maintenance benefit for car will be separately taxable.

[Part of syllabus]

- For above rule, "employee" includes a director of a company.

If in the question it is mentioned that employee is paying anything to employer in respect of service availed then this will not be deducted because as per law only 10% or 5% is to be added as the case may be.
Example: Chapter 19 (September 2011)

<u>Question-1 Car acquired through purchase (by the employer)</u>

Mr. Akif is a director of Multi Tech Ltd. The company has provided him a car as a part of his salary package. The cost of the car purchased by company is Rs. 1,000,000. Compute the amount to be added in the salary income if the car has been provided for personal use only.

<u>Answer-1</u>

Amount to be added in salary income	(10% x Rs. 1,000,000)	100,000

<u>Question-2 Car acquired on lease (by the employer)</u>

Mr. Akif is a director of Multi Tech Ltd. The company has provided him a car as a part of his salary package. The fair market value of the car is Rs. 1,200,000 at the inception of lease. Gross lease rentals payable by the employer amounts to Rs. 22,000 per month for five years. Compute the amounts to be added in the salary income of Mr. Akif if:

(a) The car has been provided for both official and personal use

(b) The car has been provided for personal use only.

<u>Answer-2</u>

(a) Amount to be added in salary income: (5% x Rs. 1,200,000)	60,000
(b) Amount to be added in salary income: (10% x Rs. 1,200,000)	120,000

<u>Note: Answer-2</u>

Value (for the purpose of Rule 5) on the basis of gross lease rentals is irrelevant i.e. Rs. 1,320,000 (22,000 per month x 12 months x 5 years) is irrelevant. We will use fair market value at the inception of lease.

(5) Where, the **services** of a housekeeper, driver, gardener or other domestic assistant are provided by an employer to an employee, the following shall be added in the salary income:

- the salary paid by employer to person providing service less amount paid by employee to employer.

"services" includes the provision of any facility;

<u>Question</u>

Mr. Usman Safdar is working as an officer in a company and he has been provided with following benefits apart from basic salary of Rs. 80,000 per month.

Driver	10,000 per month
Gardener	7,000 per month
House keeper	5,000 per month

The above payment to driver, gardener and house keeper is made by the company directly. Mr. Usman Safdar pays to the company Rs. 3,000 per month in respect of services of house keeper. Compute the amount of taxable salary for the tax year 2011 assuming that if driver is hired from market an amount of Rs. 12,000 is to be paid to him.

<u>Answer</u>

Basic Salary:	960,000
Benefits:	
Driver: (10,000 x 12)	120,000
Gardener (7,000 x 12)	84,000
Housekeeper ((5,000-3,000) x 12)	24,000
Taxable income from salary	1,188,000

(6) If utilities are provided by an employer to an employee, the "Salary" shall include the fair market value of the utilities less amount paid by the employee to employer.

"utilities" includes electricity, gas, water and telephone.

<u>Question</u>

Mr. Asfand is working for Mr. Asim. As per the terms of employment the employer pays directly for the utility bills of the accommodation to the service providers of utilities against which employee has to pay a nominal amount of Rs. 2,000 per month to the employer. The actual cost incurred by employer in whole of the tax year for utilities for Asfand's accommodation is as follows:

Water		100,000
Electricity		200,000
Gas		30,000

Basic salary per month is Rs. 50,000. Calculate taxable income.

Answer

Basic salary (50,000 x 12)		600,000
Cost incurred by employer(100,000 + 200,000 + 30,000)	330,000	
Less: Paid by employee to employer (2,000 x12)	(24,000)	306,000
Taxable income		906,000

(7) Interest free/concessional loan

Where a loan is provided by an employer to an employee the salary shall include-

Scenario	Amount to be added in salary income
Where no profit (interest) on loan is paid by an employee	Interest on loan calculated at bench mark rate
Where profit (interest) on loan paid by employee is less than benchmark rate	The difference between the profit on loan paid by the employee and profit on loan computed at the benchmark rate

However nothing will be added in the salary income if:

- the loan is upto Rs. 1,000,000.
- the interest benefit is arising because employee has waived the interest to employer when employee had provided the loan to the employer. (for example as in case of provident fund sometimes)

It means that if the employee has given an interest free loan to the employer and in compensation employer also gives to the employee an interest free loan than nothing will be added in salary income of employee irrespective of the fact that he is earning a benefit.

"BENCHMARK RATE" MEANS --

(i) for the tax year 2003, a rate of 5% per annum; and

(ii) the rate for each coming year will be increased by 1%, but a cap will be placed at 10%.

So rate for current and coming years is fix at 10%.

Question

Mr. Aafaq is an employee of ABC company. Mr. Aafaq has availed a loan of Rs. 2,000,000 in tax year 2012. What amount shall be added into his income from salary on following alternate assumptions:

(a). No profit on loan is payable to company by Mr. Aafaq

(b). Profit is payable to company at 6% per annum

(c). Profit is payable to company at 18% per annum

Answer

(a) Amount to be added in salary income on account of profit on loan. 200,000
(Rs. 2,000,000 x 10%)

(b) Amount to be added in salary income on account of profit on loan. 80,000
[Rs. 2,000,000 x (10%-6%)]

(c) Nothing will be added in his income.

(8) Where employee uses a loan obtained from employer for acquisition of any asset or property producing income under any head of income, it will be assumed that employee has paid profit (interest) equal to the benchmark rate.

Question

Mr. Asim has obtained a loan of Rs. 1,600,000 from employer on February 1, 2013 for the purpose of purchasing a shop for his business. The interest charged by employer on this loan is 4% per annum. He has provided you following details regarding TY 2013.

Details regarding business income	
Revenue earned from business	1,200,000
Expenses incurred	300,000
Details regarding salary income	
Basic salary per month	50,000
Hose rent allowance per month	30,000

Required: Calculate his taxable income?

Answer

Income from salary			
Basic Salary	(50,000 x 12)	600,000	
House rent allowance	(30,000 x 12)	360,000	
Interest benefit on loan	(1,600,000 x (10%-4%) x 5/12)	40,000	1,000,000
Income from business			
Revenue earned from business		1,200,000	
Less: Expenses incurred		(300,000)	
Less: Interest on loan calculated at benchmark rate	(1,600,000 x 10% x 5/12)	(66,667)	833,333
			1,833,333

Note: If in above case interest charged by employer is higher than bench mark rate, than actual interest paid will be allowed as expense.

(9) Where an obligation of an employee towards employer is waived by the employer, it will be added in salary.

Obligation of employees may the following:

- Loan received by an employee
- Goods or services purchased on credit by employee

Question

Mr. Anjum was entitled to the following during the tax year 2010 from his employer

Basic Salary for the tax year:	520,000
Education Allowance;	100,000

Mr. Anjum obtained loan from his employer in tax year 2005 amounting to Rs. 400,000 but was unable to pay till now. His employer has decided to waive the loan.

Required:

Compute the taxable income from salary of Mr. Anjum.

Answer

Basic Salary for the tax year:	520,000
Education Allowance:	100,000
Loan waived by the employer:	400,000
Taxable income from salary	1,020,000

(10) Where an obligation of an employee towards a third party is paid by the employer, it will be added in salary.

Question

Suppose in above example, Mr. Park also obtained loan from a Bank in tax year 2005 amounting to Rs. 380,000 but was unable to pay till present tax year. As a benefit, his employer has decided to pay the loan as well. Compute the taxable income from salary of Mr. Park for the tax year.

Answer

Salary for the tax year:	520,000
Education Allowance:	100,000
Loan waived by the employer:	400,000
Loan paid to the bank by the employer on Mr. Anjum's behalf	380,000
Taxable income from salary	1,400,000

(11) Where a property is transferred or services are provided by an employer to an employee, salary shall include:

- Fair market value of property at the time of transfer less amount paid by employee to the employer.
- Fair market value of service at the time it is provided less amount paid by employee to the employer.

Question-1

Employer of Mr. Ahsan agrees to provide pick and drop service from school to his home for his children. The monthly expenditure for the employer in this regard amounts to Rs. 15,000.

Rs. 180,000 (15,000 x 12 months) shall be added in the salary income of the Mr. Ahsan.

Question-2

Suppose Mr. Ahsan pays Rs. 2,000 per month on account of pick and drop service provided by the employer.

Amount to be added in income from salary shall be computed as follows:

mount paid by employer:	180,000
Less: Amount paid by Mr. Ahsan: (2,000 x 12 months)	(24,000)
Amount to be added in income from salary	156,000

Question-3

XYZ company has gifted a plot of land to its employee Mr. A on June 10, 2010 and its market value is Rs. 500,000. This will be added in his salary income in TY 2010.

(12) Valuation of Accommodation [Rule 4 of Income Tax Rules, 2002]

The value of accommodation provided by an employer to the employee shall be higher of:

- 45% of the minimum of the time scale of the basic salary or the basic salary or
- Amount that would have been paid by employer had no accommodation been provided

Employee includes a director of a company.

Note for students: If "Amount that would have been paid by employer had no accommodation been provided" is not given in exam than we will compare 45% of basic salary with fair market rental of property (if it is given).

Minimum of time scale

It is the amount from where the salary scale of an employee starts e.g. (5,000-1,000-7,000) means salary will starts with Rs. 5,000 with increment of Rs. 1,000 per annum upto maximum of Rs. 7,000.

Where house rent allowance is admissible @ 30% than in above provision 45% will be replaced with 30%. (Note for student: It is not general rule. It is applicable for certain Government employees if question specifically refers to it.)

Example-1

Basic salary of an employee is Rs. 100,000/ month. Employer has provided employee with 2 options:

1. Either I will provide you house in factory premises or
2. I'll give you house rent allowance of 50,000/month.

Employee has opted for home.

Calculate taxable income?

Solution:

Basic salary			1,200,000
Accommodation provided: (Higher of)			
-45% of basic salary	(1,200,000 x 45%)	540,000	
or - amount that would have been paid	(50,000 x 12 = 600,000)	600,000	600,000
Taxable income			1,800,000

Example-2

Basic salary of employee is Rs. 100,000/ month. Employer has provided employee with a home. Calculate taxable income?

Solution:

Basic salary	1,200,000
Accommodation provided (45% of 1,200,000)	540,000
Taxable income	1,740,000

Note: As a general rule higher of 45% of Basic Salary or the amount that would have been paid had no accommodation been provided is added in salary. The later one is not given. Hence, I am only adding 45% of basic salary.

Example-3

An employees is paid a basic salary of Rs.90,000 per month. Employer has provided the employee with a furnished house. The house is not owned by the employer. Fair market rent of the house is Rs.32,000 per month.

Solution:

Basic Salary (90,000 x 12)			1,080,000
Accommodation provided: (Higher of)			
- 45% of basic salary	(1,080,000 x 45%)	486,000	
or – fair market rent	(32,000 x 12 = 384,000)	384,000	486,000
			1,566,000

Note 1:

The accommodation can be either furnished (with furniture) or non-furnished (without furniture). There is no difference in tax treatment of both of these.

Example-4

Mr. Mather is an employee of ABC company. He has provided you with the following details for TY 2011.

He joined on August 1, 2010.

His basic salary per month is Rs. 40,000 and education allowance and entertainment allowance of Rs. 5,000/month and Rs. 6,000/month respectively.

Employer has offered him two options either to take home or take a monthly cash allowance of Rs. 20,000.

Mr. Mather has opted for home.

He is allowed to use the electricity, telephone and water facility in home on nominal amount of Rs. 1,000 per month charged by his employer against all of these facilities. However he pays gas bill himself. The actual amount of bills during TY 2011.

Electricity	20,000
Telephone	30,000
Gas	10,000
Water	6,000

Calculate his taxable income?

Answer-4

Basic salary	(40,000 x11)		440,000
Education allowance	(5,000 x11)		55,000
Entertainment allowance	(6,000 x11)		66,000
Accommodation facility			
Higher of: 45 % of Basic salary	(440,000x45%)	198,000	
Or amount that would have been paid had no accommodation provided	(20,000x11)	220,000	220,000
Utilities excluding gas			
Electricity		20,000	
Telephone		30,000	
Water		6,000	
Less: Paid by employee to employer (1,000 x 11)		(11,000)	45,000
Taxable income			826,000

Example-5

Mr. Uzair is an employee of Pink Panther company. He has provided you with the following details for TY 2011. He joined on September 1, 2010.

His basic salary per month is Rs. 40,000 and education allowance and entertainment allowance of Rs. 5,000/month and Rs. 6,000/month respectively.

Employer has offered him two options either to take home in factory premises or take a monthly cash allowance of Rs. 20,000/month. Mr. Uzair has opted for monthly cash allowance.

Calculate his taxable income?

Answer-5

Basic salary	(40,000 x10)	400,000
Education allowance	(5,000 x10)	50,000
Entertainment allowance	(6,000 x10)	60,000
House rent allowance	(20,000x10)	200,000
Taxable income		**710,000**

Self hiring of property [S. 15(5)]

If employee or his spouse owns a house which is given on rent to the employer and the employer has provided the same house to employee as rent free accommodation, then it will have two fold effect:

- Rent actually received by employee from employer will be income from property. (Fair market rent will be ignored) (Chapter 9)
- It will be a perquisite in the form of accommodation 45% of basic salary will be added under the head salary.

Summary of various provisions related to Assets provided / transferred

Description	**Asset is Provided (only for a specified period/ means it is returnable to employer)**	**Transferred / sold / Gifted**
Car	5% or 10% of cost for purchased vehicle 5% or 10% of FMV of vehicle obtained on lease [S.13 (3)]	Fair market value of asset at time of transfer less amount paid by employee to employer [S.13 (11)]
House	Higher of - 45% basic salary or - Amount that would have been paid . . [S.13 (12)]	Same as above
Laptop/oven/ washing machine/ Fridge etc.	Fair market rent of asset for the year less amount paid by employee to employer OR Depreciation charged by employer in his books less amount paid by employee to employer [S. 13 (11)]	Same as above

(13) Where an employer has provided a perquisite which is not covered above, the "Salary income" shall include the fair market value of the perquisite at the time it is provided, less amount paid by the employee.

Employee share schemes [Sec. 14]

"Employee share scheme" means any agreement under which a company may issue shares in the company to:

(a) an employee of the company or an employee of an associated company; or

(b) the trustee of a trust and the trustee may transfer the shares to an employee of the company or an employee of an associated company.

Basic understanding of operation of employee share scheme

(a) Terminologies

i.	Right /Option	Simply, A letter stating that employee has a right to acquire shares at a particular rate
ii.	Exercise of right/ Purchase of shares	Person with the right letter purchases the shares at the rate mentioned in the right letter. He then becomes the owner of shares.
iii.	Face value of a share	The denomination of the share. Generally it is Rs. 10 per share.
iv.	Market value of a share	Price at which the share is traded in the stock market. This may be less than, equal to or more than face value.

(b) Following events take place in employee shares scheme

Announcement of scheme →Issuance of Right letter→Exercise of right or Issuance of shares by the company

(1) Value of right/option (Taxability at time of grant of right or option)

The value of a right or option to acquire shares under an employee share scheme is not chargeable to tax.

(5) Disposal of right or option/ Sale of right or option

Where, in a tax year, an employee disposes of a right or option to acquire shares under an employee share scheme, the amount chargeable under the head "Salary" shall include the amount of any gain as calculated below:–

A-B

where –

A is the consideration received for the disposal of the right or option; and

B is the employee's cost in respect of the right or option.

Formula for disposal of right

Consideration received for the disposal of the right or option	xxx
Less: Cost of right or option	(xxx)
	xxx

(2) Exercise of right/Acquisition of shares/Issue of shares by company

Where shares are issued to an employee under an employee share scheme (including as a result of the exercise of an option), following amount is chargeable:

- the fair market value of the shares at the date of issue less consideration given by the employee for the shares and for rights or options.

Formula for exercise of right

fair market value of the shares at the date of issue	xxx
Less: Cost of share	(xxx)
Less: Cost of right	(xxx)
	xxx

(3) Shares issued by company with restriction on transfer

Where shares are issued to an employee under an employee share scheme and there is a restriction on the transfer nothing will be added in the income until the employee has a free right to transfer the shares. On getting the free right to transfer, the salary shall include the fair market value of the shares at the time the employee has a free right to transfer the shares less consideration given by the employee for the shares and for rights or options.

However if the employee disposes off the shares before getting the free right to transfer the shares, the salary shall include the fair market value of the shares at the time the employee disposes of the shares less consideration given by the employee for the shares and for rights or options.

(4) Calculation of cost of shares for computing Tax credit / capital gain at the time of disposal

The cost of the shares shall be sum of –

(a) the consideration given by the employee for the shares;
(b) the consideration given by the employee for the grant of right or option; and
(c) the amount chargeable to tax under the head "Salary".
[For details refer examples of Section 14(4) in Chapter 10]

Note
1. In case of disposal of shares of private company and public unlisted company, gain will be chargeable under the head capital gain.
2. In case of disposal of shares of public company, gain will be taxed as separate block because shares of public company fall under the definition of securities.

Question-1

PTCL has announced an employee share scheme. Following persons purchased the rights.

Cost of right/share	Rs. 1/share
Ali has acquired right to purchase	800 shares
Shujat has acquired right to purchase	1,000 shares
Waleed has acquired right to purchase	1,500 shares

On the date the shares were to be issued following events took place

(1) Ali sold all rights to Ramzan for Rs. 5 per right.
(2) Shujat exercised right by paying Rs. 70/share. FMV of the share acquired by Shujat at the time of exercise of right was Rs. 82/share.
(3) Waleed did not exercise the right.

Answer-1

Ali

Consideration for sale	(5 x 800)	4,000
Less: Cost of right	(1 x 800)	(800)
Gain		3,200

Shujat

Fair market value of shares	(82x1,000)	82,000
Less: Cost of shares	(70 x 1,000)	(70,000)
Less: Cost of right	(1 x 1,000)	(1000)
Gain		11,000

Waleed

Nothing will be added in his income as he has not exercised the rights.

Question-2

Mr. Waleed paid Rs. 30 to acquire right to purchase 1,000 shares. Shares were issued to him on 23 June, 2010. He exercised the right by paying Rs. 33/share.

On June 23, 2010 the market value was Rs. 40/share. As per the scheme of company, the shares can only be transferred after holding them for 2 years.

The FMV of shares is Rs. 45/share on 23 June, 2012.

Calculate taxable income for TY 2010 and TY 2012?

Answer-2

Calculation of taxable income

TY 2010

Nothing will be added in the income as he has no free right to dispose the shares.

TY 2012

Fair market value of shares	(45 x 1,000)	45,000
Less: Cost of share	(33 x 1,000)	(33,000)
Less: Cost of right		(30)
		11,970

Question-3

Mr Ardesheer Petigara as a past employee of Super Power Inc (SPI) was entitled to participate in the SPI Employee Share Scheme (Scheme). On 1 July 2009, AP received the right to purchase 2,000 shares in SPI at the exercise price of US$ 15 per share. Under the terms of the Scheme, any shares issued to an employee can only be transferred after a holding period of three years. No consideration was payable for the right to acquire the 2,000 shares.

On 1 June 2010, the price of one share quoted on the SF stock exchange was US$ 20. On the same day, AP exercised his right to purchase 1,000 shares at the exercise price of US$ 15 per share and remitted US$ 15,000 to the custodian of the Scheme. The remaining 1,000 rights were sold by AP for Rs. 300,000. (The rate of exchange is to be taken at US$ 1 = Rs. 80).

Required:

Calculate the taxable income of Ardesheer Petigara for the tax year 2010.

Answer-3

As per the provisions of ITO 2001,

Where shares are issued to an employee under an employee share scheme and there is a restriction on the transfer nothing will be added in the income until the employee has a free right to transfer the shares. So these will be added in salary income when he gets the free right to transfer.

Only gain on sale of rights to purchase shares will be taxable in Tax Year 2010.

	Rs.
Income from Salary	
Disposal of Rights	
Consideration received	300,000
Less : Cost of Rights	0
Taxable Gain	300,000

Question-4

Mr. Pestonji had participated in the HSP employee share scheme:

- On 1 July 2006, Pestonji purchased the right to acquire 1,000 shares in HSP at the exercise price of 100 per share.
- There was no payment to be made for the right to acquire these 1,000 shares in HSP. The value of one right was Rs. 20.
- On 31 July 2006, Pestonji sold the rights for 500 shares for Rs. 25,000.
- On 1 September 2006, Pestonji exercised his remaining rights to purchase 500 shares in HSP at the exercise price of 100 per share. The market price of one share on that date was 150. The 500 shares purchased were in Pestonji's possession on 30 June 2007.

Required:

Calculate the taxable income of Pestonji for the tax year 2007

Answer-4

			Rs.
Income from salary – Tax Year 2007			
Disposal of Right			25,000
Exercise of Right			
- FMV of Shares	(500 x 150)	75,000	
- Less: Consideration Given for rights	(500 x 100)	(50,000)	25,000
Taxable Gain			50,000

Question-5

Ring had participated in the employee share scheme of Telephones (Pvt) Ltd:

- On 1 September 2005, Ring purchased the right to acquire 2,000 shares in TPL at the exercise price of £10 per share.
- The right to acquire the shares could be exercised at any time before 31 August 2006.
- There was no payment to be made for the rights. The custodian estimated the value of one right to be £2 and the exchange rate was £1 = Rs.100.
- On retirement from the employment of TPL, Ring disposed of the rights for Rs.30,000 on 31 December 2005.

Required:

Calculate the taxable income of Ring for the tax year 2006

Answer-5

	Rs.
Income from Salary- 2006	
Disposal of Right	30,000

Question-6

25 June 2013: Aslam Sold 100,000 call options (right to purchase shares) in a public company listed on the Islamabad Stock Exchange at Rs. 2·5 per call option. He had purchased these call options on 20 June 2013 at Rs. 1·90 per call option. Other admissible expenses incurred on these transactions were Rs. 10,000.

Required:

Calculate the taxable income of Aslam for the tax year 2013

Answer-6

		Rs.	Rs.
Sale of call options(rights)			
Consideration received	(100,000 x 2·5)		250,000
Less: Cost of Call option	(100,000 x 1·9)	190,000	
Other admissible expenditure		10,000	(200,000)
			50,000

Question-7

Slumdog participated in the employee share scheme of Adopter Ltd. The following information is provided to you for the Tax Year 2013:

i) On 1 September 2012, Slumdog was granted the right to acquire 2,000 shares in Adopter Ltd at the exercise price of Rs. 100 per share.
ii) The right to acquire the shares could be exercised at 31 August 2013.
iii) There was no payment to be made for the rights. The value of one right was Rs. 200.
iv) On 31 December 2012, Slumdog disposed of the rights for Rs. 30,000.

Required:

Calculate the taxable income of Slumdog for the tax year 2013.

Answer-7

	Rs.
Calculation of Taxable Income – TY 2013	
Income from Salary	
Employee share scheme – sale of rights (Note)	30,000
Less: Cost	(0)
Taxable Income	30,000

Note

The gain on the disposal of rights is chargeable as salary income. As no payment was made by for rights, the entire Rs. 30,000 is chargeable to tax as salary income.

Question-8

Super Power Inc (SPI) has announced an employee share scheme. Following is the information for the Tax Year 2013:

Mr. Sharjah as an employee of Super Power Inc (SPI) was entitled to participate in SPI Employee Share Scheme (Scheme). On 1 July 2012, Mr. Sharjah received the right to purchase 2,000 shares in SPI at the exercise price of US$ 15 per share. Under the terms of the Scheme, any shares issued to an employee can only be transferred after a holding period of 3 years. No consideration was payable for the right to acquire the 2,000 shares.

On 1 June 2013, the price of one share quoted on Karachi stock exchange was US$ 20. On the same day, Mr. Sharjah exercised his right to purchase 1,000 shares at the exercise price of US$ 15 per share and remitted US$ 15,000 to the custodian of the Scheme. The remaining 1,000 rights were sold by Sharjah for Rs. 300,000. (The rate of exchange is to be taken at US$ 1 = Rs. 80).

Required:

Calculate taxable income of Mr. Sharjah under the head income from salary under TY 2013.

Answer-8

Calculation of Taxable Income – TY 2013

	Rs.
Income from Salary	300,000
Sale of rights (Note)	(0)
Less: Cost	300,000
Taxable Income	

Item not included

In an employee share scheme, where there is a restriction on the transfer of shares, the benefit is chargeable at the time the employee has the free right to transfer the shares or when the employee disposes of the shares, whichever is the earlier

Therefore, no adjustment is required to be made in the computation of taxable income.

Question-9

Mr. Scooby is preparing his return of income for the year ended 30 June 2009 and he has furnished you with the following details:

(1) Mr. Scooby was employed with Fashions Private Limited. He has opted to participate in the Employee Share Scheme. The terms of the Scheme allowed a participant the free right to transfer the shares issued under the Scheme, only after a minimum holding period of 9 months.

(2) On 1 July 2008, Mr. Scooby was granted the right to acquire 4,000 shares in FPL at the exercise price of Rs. 250 for one share. The Rs. 250 was inclusive of a consideration of Rs. 25 for the grant of the right to acquire the shares. Based on the then quoted price of one share in FPL on the Karachi Stock Exchange , the value of the right to acquire one share in FPL on 1 July 2008 was estimated by the custodian of the Scheme to be Rs. 30. On 1 July 2008, Mr. Scooby accepted the rights offered to him and made payment of Rs.100,000 to the custodian. On 1 July 2008, Mr. Scooby exercised his right to acquire the 1,000 shares in FPL and made the balancing payment of 225,000 (Rs. 225 per share), having paid Rs. 25,000 at the time of acceptance of the rights. The price quoted for one share in FPL on the Karachi stock exchange on 1 April 2009 was Rs. 500.

(3) On 7 July 2008, Mr. Scooby disposed of the rights relating to 3,000 shares in FPL for Rs. 375,000

Required:

Calculate the taxable income of Mr. Scooby for the tax year 2009.

Answer-9

Computation of taxable income		Rs.
Income from Salary:		
Employee share scheme		
Gain on the disposal of the rights to acquire 3,000 shares	(Note 1)	300,000
Benefit on the acquisition of 1,000 shares	(Note 2)	250,000
Taxable Income		550,000

Items included in the computation of taxable income

(1)

Gain on sale of right/ option		Rs.
Consideration received on the disposal of the rights		375,000
Cost of the rights	(25 x 3000)	(75,000)
		300,000

(2) **Exercise of Right**

		Rs.	Rs.
FMV of 1,000 shares in FPL	(500 x 1000)		500,000
Consideration paid at the time of:			
- accepting the right	(25 x 1,000)	25,000	
- exercising the right	(225 x 1,000)	225,000	(250,000)
			250,000

Items not included in the computation of taxable income:

The value of a right or option to acquire shares in an employee share scheme granted to an employee is not chargeable to tax Therefore the value of Rs. 30 assigned to the right to acquire one share in FPL by the custodian is not treated as the income of Mr. Scooby in the computation of income.

Self test Questions

Question-1

A company launched an employee share scheme. Mr. Umer brought the right to purchase shares on 25.06.2013 by paying Rs. 5,000. He exercised the right to purchase 3,000 shares on 31st August 2013 at exercise price of Rs. 120 per share. According to scheme he was not allowed to transfer the shares before completion of 2 years. FMV of shares were as follows:

31 Aug 2013	Rs. 180
30 June 2014	Rs. 200
31 Aug 2015	Rs. 230

Compute amount to be included in income for TY 2013, 2014, 2015 and 2016.

Answer-1

Question-2

Mr Atif purchased the right to purchase 5,000 shares by paying Rs. 2,000. Right is purchased on 20.Aug.2013. On 25 June 2015 he exercised the right and purchased the shares by paying Rs 334 per share. FMV of shares on that date is Rs. 370 per share. All of the shares are sold on 25 June 2016 for Rs. 430 per share.

Compute amount to be included in income for TY 2014, 2015 and 2016.

Answer-2

Question-3

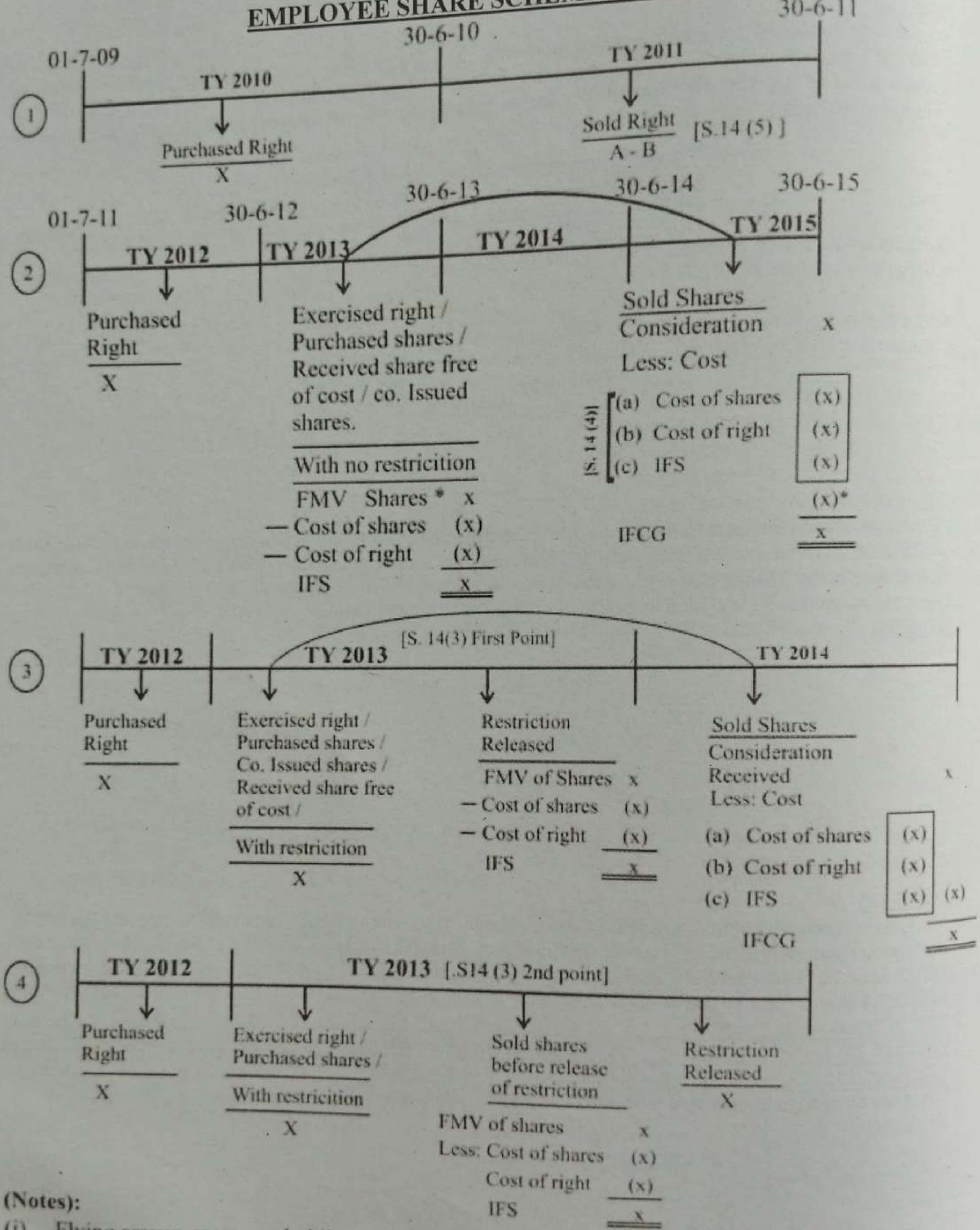
Mr. Qasim purchased rights for Rs. 8,000 on 12 March 2013. The value of rights on that date was Rs 10,000. By buying rights he got the right to buy 20,000 shares. On 25 Sep 2013 he sold half of the rights for Rs. 7,000. On 22 June 2014 he exercised the remaining rights by paying Rs. 83 per share. There was a restriction on transfer of shares for 1 year. However he sold the shares on 10 Jan 2015 for Rs. 90 per share. FMV of shares were as follows:

22 June 2014	Rs. 85/ share
22 June 2015	Rs. 89/ share

Compute amount to be included in income in Ty 2013, 2014 and 2015.

Answer-3

EMPLOYEE SHARE SCHEME SUMMARY



(Notes):

(i) Flying arrows represent holding period calculation for calculating capital gain

(ii) It is not necessary that employer first gives right. An employee may directly purchase shares.

(iii) Exercise price means the amount paid by employee at time of purchase of shares.

(iv) Value of rights/option is always to be ignored in questions

Foreign source salary of resident individuals [Sec. 102]

(1) Any foreign-source salary received by a resident individual shall be exempt if the individual has paid foreign income tax on salary.

(2) It will be assumed that resident individual has paid foreign income tax if tax is withheld from salary by the employer and paid to the revenue authority of the foreign country.

Question

Mr. Amjad a citizen of Pakistan is employed in XYZ company. He worked in XYZ company from Jul 1, 2010 to January 31, 2011. He got a job in Nepal where he joined on February 1, 2011. His monthly salary in Pakistan is Rs. 60,000 per month. His monthly salary in Nepal is Rs. 90,000 in Pak rupees. On May 31, 2011 he decided to resign from the Nepalian job and came back in Pakistan on the same date. Since then he has yet not got any job. He has duly paid the tax to Nepalian Government authorities on his income earned there.
Calculate his taxable income for TY 2011?

Answer

Salary income (PSI)	(60,000x7)	420,000
Salary income (FSI)	Exempt	-
Taxable Income		**420,000**

Foreign source salary income is exempt because he has duly paid the tax on it.

[Section 51(2)]

Where a citizen of Pakistan leaves Pakistan during a tax year and remains abroad during a tax year than salary income earned outside Pakistan during that year shall be exempt from tax.

Note: In such case even if no tax is paid the foreign source salary income will remain exempt.

Question-1

Mr. Arslan a citizen of Pakistan is employed in XYZ company. He worked in XYZ company from Jul 1, 2010 to January 31, 2011. He got a job in Saudi Arabia where he joined on March 1, 2011. He departed from Pakistan on February 20, 2011. His monthly salary in Pakistan is Rs. 50,000 per month. His monthly salary in Saudi Arabia is Rs. 80,000 in Pak rupees. As on June 30^{th} he was still in Saudi Arabia. He did not paid any tax on his salary in Saudi Arabia. Calculate his taxable income?

Answer-1

Salary income (PSI)	(50,000x7)	350,000
Salary income (FSI)	Exempt	-
Taxable Income		**350,000**

Because Arslan remained outside Pakistan at the end of tax year, therefore his foreign source salary income is exempt from tax irrespective of whether he has paid foreign income tax or not.

Question-2

Mr. Amjad a citizen of Pakistan is employed in XYZ company. He worked in XYZ company from Jul 1, 2010 to January 31, 2011. He got a job in Saudi Arabia where he joined on March 1, 2011. He departed from Pakistan on February 20, 2011. His monthly salary in Pakistan is Rs. 50,000 per month. His monthly salary in Saudi Arabia is Rs. 80,000 in Pak rupees. On May 31, 2011 he decided to resign from the Saudi job and came back in Pakistan on the same date. Since then he has yet not got any job. He did not paid any tax on his salary in Saudi Arabia as there is no tax on salaries there.
Calculate his taxable income for TY 2011?

Answer-2

Salary income (PSI)	(50,000x7)	350,000
Salary income (FSI)	(80,000x3)	240,000
Taxable Income		**590,000**

Because Amjad didn't remain outside Pakistan at the end of tax year, therefore his foreign source salary income is chargeable to tax.

Important Exemptions in Second Schedule Part 1

Important terms relating to exemptions taxation and retirement benefits:

Various terms to be understood before reading exemptions

1. Pension: It is a series of monthly payment after the retirement of an employee.
2. Commutation of pension: It is a lump-sum payment of a certain portion of pension for certain years, paid in advance to employee at the time of retirement.
3. Provident Fund: It will be discussed in upcoming paras.
4. Gratuity:

Example

An Employee worked for 10 years from age of 35-45 years. His salary at the time of retirement for the month of December was Rs.30,000. He is entitled to gratuity on the basis of last drawn gross salary multiplied by number of years worked. Calculate gratuity payable?

Solution

Gratuity = Number of years x last drawn gross salary
=10 x Rs.30,000
=Rs. 300,000

(8) Any pension received by a citizen of Pakistan from a former employer shall be exempt. If person continues to work for the employer (or an associate of the employer) then it will be chargeable.
If a person receives more than one pension, then only higher pension will be exempt.
If a person's age is more than 60 years than all pensions shall be exempt irrespective of above mentioned conditions.
Pension received by employee of Armed forces or Federal or Provincial Government is exempt.

Mr. A is working as CFO in Bahria Traders since 2009. From 1990 to 2000 he worked for a private hospital and from 2001 to 2008 he worked for a private school. In TY 2011 he received pension of Rs. 5,000/month from private hospital and Rs. 6,000/month from private school. Rs. 60,000 (5,000 x 12) will be added in his salary income. Rs. 72,000 (6,000 x 12) will be exempt.

(12) Commutation of pension received from Government or pension scheme approved by Board shall be exempt.
(13) Gratuity or commutation of pension received on retirement or, in the event of his death, by his heirs:

(i)	Government employees	Fully exempt
(ii)	Gratuity fund approved by Commissioner	Fully exempt
(iii)	Gratuity scheme approved by the Board	Exempt upto Rs. 300,000 if scheme is applicable to all employees
(iv)	-Unapproved gratuity -Unapproved commutation of pension	In the case of any employee to whom sub-clause (i),(ii) and (iii) do not apply, the amount exempt will be lower of following; - 50% of the amount receivable or - Rs. 75,000

[Part of syllabus]

The exemption on Unapproved gratuity or Unapproved commutation of pension shall apply–
(a) if payment is received in Pakistan;
(b) in case of director, if payment is received by him being a regular employee;
(c) if payment is received by a resident; and
(d) to gratuity received by an employee who has not received any gratuity from the same or any other employer.

Question-1

Mr. Arslan is employed in XYZ company. His basic salary is Rs.40,000/month. In TY 2011 he resigned on March 31, 2011 and received Rs. 90,000 from unapproved gratuity fund.

Answer-1

Basic salary	(40,000 x 9)		360,000
Gratuity		90,000	
Exempt up to lower of:	75,000 50% of 90,000 = 45,000	(45,000)	45,000
Taxable Income			405,000

Question-2

Mr. Asim is employed in XYZ company. His basic salary is Rs.40,000/month. In TY 2011 he resigned on March 31, 2011 and received Rs. 470,000 from gratuity scheme approved by FBR and Rs. 200,000 commutation of pension(un approved).

Answer-2

Basic salary	(40,000x9)		360,000
Gratuity scheme		470,000	
Exempt up to		(300,000)	170,000
Unapproved commutation of pension		200,000	
Exempt up to lower of:	75,000 50% of 200,000 = 100,000	(75,000)	125,000
Taxable Income			**655,000**

(22) Any payment from a provident fund to which the Provident Funds Act, 1925 applies.

(24) Benevolent fund

Any benevolent grant paid from a Benevolent Fund to employees or members of their families is exempt.

(25) The tax treatment for Superannuation fund is as under:

a. Employer's contribution and interest is exempt
b. Payment of accumulated balance from an approved superannuation fund on death of a beneficiary is exempt.
c. Where any contribution made by an employer (including interest) is repaid to an employee during employee's life-time, tax on that amount shall be deducted at rate applicable to the year of withdrawal.

(53A) The following perquisites received by an employee shall be exempt:-

(ii) Free or subsidized food provided by hotels and restaurants to its employees during duty hours;
(iii) Free or subsidized education provided by an educational institution to the children of employees;
(iv) free or subsidized medical treatment provided by a hospital/clinic to its employees; and
(v) other benefit for which the employer do not bear any marginal cost, as notified by Board.

Question-1

Mr. Arham is teaching in Elite college. His basic salary is Rs.40,000/month. Dearness allowance is Rs. 2,000/ month and house rent allowance is Rs. 6,000/month. His child is also getting education in the same school. The college charges a concessional fee of Rs. 40,000 per annum against the market charge of Rs. 65,000. Calculate his taxable income.

Answer-1

Basic salary	(40,000x12)	480,000
Dearness allowance	(2,000x12)	24,000
House rent allowance	(6,000x12)	72,000
Taxable Income		**576,000**

Subsidized education provided by the college is exempt under clause 53A of Part-1 Second Schedule.

(139) **Medical facility/reimbursement or medical allowance**

Types	Tax treatment
Medical facility/Reimbursement of medical expenses is provided as per terms of employment	Exempt (Provided that National Tax Number of the hospital or clinic, as the case may be, is given and the employer also certifies and attests the medical or hospital bills)
Medical facility/Reimbursement of medical expenses not as per terms of employment	Fully taxable
Only Medical allowance	Exempt upto 10% of basic salary.
Medical allowance + Medical facility/ Reimbursement of medical expenses in accordance with terms of employment	Allowance is fully taxable. Facility/Reimbursement will be exempt.
Medical allowance + Medical facility/ Reimbursement of medical expenses not in accordance with terms of employment	Allowance is exempt upto 10% of basic salary. Facility/Reimbursement will be fully taxable.

Exam note:

1. The term medical facility (hospitalization) comprises of the following scenarios:
    a) Medical insurance for hospitalization is borne by employer;
    b) Reimbursement of medical expense on account of hospitalization is made by employer;
    c) Hospitalization is provided by insurance policy;
    d) Personal medical expenses of employee are reimbursed by employer; and
    e) Free medical treatment is provided by employer to employee.
2. If in income from salary question, both medical allowance and medical facility are given and medical facility is as per terms, medical allowance will be fully taxable and facility will be exempt.

Question-1

Basic salary of Mr. Zaryab is Rs.40,000/month. Dearness allowance is Rs. 4,000/ month and house rent allowance is Rs. 6,000/month. As per the terms of employment he is entitled for free hospitalization for which employer incurred cost of Rs. 30,000.

Calculate his taxable income?

Answer-1

Basic salary	(40,000x12)	480,000
Dearness allowance	(4,000x12)	48,000
House rent allowance	(6,000x12)	72,000
Hospitalization (Exempt being as per terms of employment)		-
Taxable Income		**600,000**

Question-2

Basic salary of Mr. Ali Butt is Rs.40,000/month. Dearness allowance is Rs. 4,000/ month and house rent allowance is Rs. 6,000/month. Medical allowance is 15% of basic salary.

Calculate his taxable income?

Answer-2

Basic salary	(40,000x12)		480,000
Dearness allowance	(4,000x12)		48,000
House rent allowance	(6,000x12)		72,000
Medical allowance	(480,000x15%)	72,000	-
Less: Exempt upto 10% of basic salary	(480,000x10%)	(48,000)	24,000
Taxable Income			**624,000**

Question-3

Basic salary of Mr. Arman Khan is Rs.40,000/month. Dearness allowance is Rs. 4,000/ month and house rent allowance is Rs. 6,000/month. As per the terms of employment he is entitled for free hospitalization for which employer incurred cost of Rs. 30,000 which is in addition to medical allowance of Rs. 3,000/month.

Calculate his taxable income?

Answer-3

Basic salary	(40,000x12)	480,000
Dearness allowance	(4,000x12)	48,000
House rent allowance	(6,000x12)	72,000
Medical allowance (Fully taxable)	(3,000x12)	36,000
Hospitalization (Exempt being as per terms)		-
Taxable Income		**636,000**

Question-4

Basic salary of Mr. Anzah is Rs.40,000/month. Dearness allowance is Rs. 4,000/ month and house rent allowance is Rs. 6,000/month. Medical allowance is Rs. 5,000/month. Free hospitalization provided cost Rs. 50,000 which is not as per terms of employment.

Calculate his taxable income?

Answer-4

Basic salary	(40,000x12)	480,000
Dearness allowance	(4,000x12)	48,000

House rent allowance	(6,000x12)		72,000
Hospitalization (Chargeable being not as per terms)			50,000
Medical allowance	(5,000x12)	60,000	
Less: Exempt upto 10% of basic salary	(480,000x10%)	(48.000)	12,000
Taxable Income			**662,000**

Annuities
Annuities (or any supplement to annuity) are taxable as salary even it is paid voluntarily. All the annuities are taxable in the normal manner

Leave Encashment (Clause 19 Part 1 of 2nd Schedule)
Any amount received on encashment of leave preparatory to retirement is exempt, if received from Government.

Worker's Profit Participation Fund (WPPF) (Clause 26 Part 1 of 2nd Schedule)
It is fully exempt.

Allowances etc., to person working outside Pakistan
Any allowance paid outside Pakistan by Government to a citizen for rendering service outside Pakistan.

Taxation of Provident Fund

a. Recognized Provident Fund

Employee contribution
No treatment as the amount is paid from salary.

Employer's contribution **(Clause 3 Part 1 of 6th Schedule)**
Employer's contribution to fund is exempt upto lower of:
- 1/10th of salary* or
- Rs. 150,000

Interest on Fund balance **(Clause 3 Part 1 of 6th Schedule)**
Interest is exempt upto higher of:
- 1/3th of salary* or
- Interest calculated at 16%.

Accumulated balance **(Clause 4 Part 1 of 6th Schedule)**
Whole of the receipt is exempt.
*"salary" for the purposes of provident fund means basic salary and dearness allowance. (it excludes all other allowances and perquisites).

Question-1
Basic salary of Mr. Abu bakar is Rs.40,000/month. Dearness allowance is Rs. 4,000/ month and house rent allowance is Rs. 6,000/month. Employee contribution in provident fund is Rs. 4,000/month and the same amount is contributed by the employer. Interest credited during t9he year is Rs. 18,000 at the rate of 18 % per annum. The fund is recognized. Calculate taxable income.

Answer-1

Basic salary	(40,000x12)		480,000
Dearness allowance	(4,000x12)		48,000
House rent allowance	(6,000x12)		72,000
Employers contribution	(4,000x12)	48,000	
Less: Exempt upto lower of:			
- 150,000			
- 52,800 (1/10 of (480,000+48,000))		(52,800)	-
Interest on provident fund		18,000	
Less: Exempt upto higher of:			
- 16,000 (18,000/18x16)			
- 176,000 (1/3 of (480,000+48,000))		(176,00	-
Taxable Income			600,000

Question-2

Basic salary of Mr. Junaid is Rs.20,000/month. Dearness allowance is Rs. 4,000/ month and house rent allowance is Rs. 6,000/month. Employee contribution in provident fund is Rs. 6,000/month and the same amount is contributed by the employer. Interest credited during the year is Rs. 100,000 at the rate of 14 % per annum. The fund is recognized. Calculate taxable income.

Answer-2

Basic salary	(20,000x12)		240,000
Dearness allowance	(4,000x12)		48,000
House rent allowance	(6,000x12)		72,000
Employers contribution	(6,000x12)	72,000	
Less: Exempt upto lower of			
- 150,000			
- 28,800 (1/10 of (240,000+48,000))		(28,800)	43,200
Interest on provident fund		100,000	
Less: Exempt upto higher of:			
- 114,286 (100,000/14x16)			
- 96,000 (1/3 of (240,000+48,000))		(114,286)	-
Taxable Income			403,200

Question-3

Basic salary of Mr. Irfan is Rs.20,000/month. Dearness allowance is Rs. 4,000/ month and entertainment allowance is Rs. 6,000/month. Employee contribution in provident fund is Rs. 6,000/month and the same amount is contributed by the employer. Interest credited during the year is Rs. 100,000. The fund is recognized. Calculate taxable income.

Answer-3

Basic salary	(20,000x12)		240,000
Dearness allowance	(4,000x12)		48,000
Entertainment allowance	(6,000x12)		72,000
Employers contribution	(6,000x12)	72,000	
Less: Exempt upto lower of			
- 150,000			
- 28,800 (1/10 of (240,000+48,000))		(28,800)	43,200
Interest on provident fund		100,000	
Less: Exempt upto	(1/3 of (240,000+48,000))	(96,000)	4,000
Taxable Income			407,200

Note: If rate of interest is not given we will simply compare with 1/3 of salary.

Question-4

Mr. Babar is an employee of ABC company. He has provided you with the following details for TY 2011. His basic salary is Rs.40,000/month. Dearness allowance is Rs. 2,000/ month and house rent allowance is Rs. 6,000/month. Employee contribution in provident fund is Rs. 4,000/month and the same amount is contributed by the employer. Interest credited during the year is Rs. 40,000 at the rate of 18 % per annum. He decided to retire with effect from April 30, 2011.The fund is recognized under 6th Schedule of ITO, 2001.At the time of retirement he received Rs. 800,000 which has been accumulated in the fund over the years. It comprised of the following.

Employer contribution to date	300,000
Employee contribution to date	300,000
Interest to date	200,000
	800,000

Calculate his taxable income.

Answer-4

Basic salary	(40,000x10)		400,000
Dearness allowance	(2,000x10)		20,000
House rent allowance	(6,000x10)		60,000
Employers contribution	(4,000x10)	40,000	

Less: Exempt upto lower of - 150,000 - 42,000 (1/10 of (400,000+20,000))	(42,000)	-
Interest on provident fund	40,000	
Less: Exempt upto higher of - 35,556 (40,000/18x16) - 140,000 (1/3 of (400,000+20,000))	(140,000)	-
Taxable Income		**480,000**

Accumulated balance is exempt.

b. Government Provident Fund

Employee contribution

No treatment as the amount is paid from salary.

Employer's contribution and Interest on Fund balance

It is exempt under income tax ordinance 2001.

Payment of accumulated balance

It is exempt under income tax ordinance 2001.

Question-1

Mr. Ahsan is an employee of Federal Government. His basic salary is Rs.40,000/month. Dearness allowance is Rs. 2,000/ month and house rent allowance is Rs. 6,000/month. Employee contribution in provident fund is Rs. 4,000/month and the same amount is contributed by the employer. Interest credited during the year is Rs. 18,000 at the rate of 18 % per annum. Calculate taxable income.

Answer-1

Basic salary	(40,000x12)	480,000
Dearness allowance	(2,000x12)	24,000
House rent allowance	(6,000x12)	72,000
Taxable Income		**576,000**

Employer's contribution and interest credited on fund is fully exempt because the fund is a Government Provident fund.

c. Unrecognized Provident Fund

Employee contribution

No treatment as the amount is paid from salary.

Employer's contribution and Interest on Fund balance

It will not be taxed in each year.

Payment of accumulated balance

Whole of the employer's contribution to date along with interest will be taxable.

(Final amount received – whole employee contribution)

Comprehensive Question relating to Provident Fund

Mr. Safdar got retired on 31st March, 2012 and has provided the following data:

	2010	2011	2012
	Rs.	Rs.	Rs.
Basic salary/Month	70,000	80,000	90,000
Dearness allowance/month	10,000	15,000	20,000
House rent allowance/month	30,000	35,000	40,000

Other data regarding provident fund:	2010	2011	2012	Total
Employer contribution	126,000	144,000	121,500	391,500
Employee contribution	126,000	144,000	121,500	391,500
Interest thereon	40,000	60,000	58,000	158,000

Interest is credited @ 17%.

Required:

Calculate taxable income assuming:

1) He is working in a private company where the provident fund is recognized.
2) He is working in a private company where the provident fund is not recognized.
3) He is working in a Government organization.

Solution

1) **Fund is recognized**

TY 2010

Income from salary:

Basic salary	(70,000 x 12)			840,000
Dearness allowance	(10,000 x 12)			120,000
Rent allowance	(30,000 x 12)			360,000
Employer's contribution			126,000	
Less: Exempt (lower of):				
- 10% of (840,000 + 120,000)		96,000		
- 150,000		150,000	(96,000)	30,000
Interest			40,000	
Less: Exempt (higher of):				
- 1/3 of (840,000 + 120,000)		320,000		
- 40,000/17% x 16%		37,647	(320,000)	-
				1,350,000

TY 2011

Income from salary:

Basic salary	(80,000 x 12)			960,000
Dearness allowance	(15,000 x 12)			180,000
Rent allowance	(35,000 x 12)			420,000
Employer contribution			144,000	
Less: Exempt (lower of):				
- 10% of (960,000 + 180,000)		114,000		
- 150,000		150,000	(114,000)	30,000
Interest			60,000	
Less: Exempt (higher of):				
- 1/3 of (960,000 + 180,000)		380,000		
- 60,000/17% x 16%		56,471	(380,000)	-
				1,590,000

TY 2012

Income from salary

Basic salary	(90,000 x 9)			810,000
Dearness allowance	(20,000 x 9)			180,000

Rent allowance	(40,000 x 9)			360,000
Employer contribution			121,500	
Less: Exempt (lower of):				
- 10% of (810,000 + 180,000)		99,000		
- 150,000		150,000	(99,000)	22,500
Interest			58,000	
Less: Exempt (higher of):				
- 1/3 of (810,000 + 180,000)		330,000		
- 58,000/17% x 16%		54,588	(330,000)	-
Accumulated balance	(exempt)			-
				1,372,500

2) Fund is not recognized

TY 2010

Income from salary:

Basic salary	(70,000 x 12)	840,000
Dearness allowance	(10,000 x 12)	120,000
Rent allowance	(30,000 x 12)	360,000
		1,320,000

TY 2011

Income from salary:

Basic salary	(80,000 x 12)	960,000
Dearness allowance	(15,000 x 12)	180,000
Rent allowance	(35,000 x 12)	420,000
		1,560,000

TY 2012

Income from salary

Basic salary	(90,000 x 9)		810,000
Dearness allowance	(20,000 x 9)		180,000
Rent allowance	(40,000 x 9)		360,000
Accumulated balance	- Employer contribution	391,500	
	- Interest	158,000	549,500
			1,899,500

3) Government employee

TY 2010

Income from salary:

Basic salary	(70,000 x 12)	840,000
Dearness allowance	(10,000 x 12)	120,000
Rent allowance	(30,000 x 12)	360,000
		1,320,000

TY 2011

Income from salary:

Basic salary	(80,000 x 12)	960,000
Dearness allowance	(15,000 x 12)	180,000
Rent allowance	(35,000 x 12)	420,000
		1,560,000

TY 2012

Income from salary

Basic salary	(90,000 x 9)	810,000
Dearness allowance	(20,000 x 9)	180,000
Rent allowance	(40,000 x 9)	360,000
		1,350,000

ICAP PAST PAPER QUESTIONS

Question-1

Under what circumstances a resident individual is entitled to claim exemption from tax on his foreign source salary, and when is the foreign tax treated as having been paid? (4)

(Q.6(a) September 2003)

Question-2

A nationalized bank after privatization has announced a Golden Hand Shake Scheme for its employees under which lump sum payments are proposed to be made to employees who opt for the scheme. Discuss the chargeability of above amounts in the hands of employees. (4)

(Q.8 September 2005)

Question-3

Briefly explain the taxability or exemption of the following allowances or perquisites:

(i) Leased motor vehicle provided to an employee, exclusively for his personal use.

(ii) Medical allowance paid at 10% of basic salary. (6)

(Q. 1 (a)March 2007)

Question-4

A company intends to launch an Employee Share Scheme for its employee and for the purpose of educating its employees in this regards, the management wants to prepare a summary containing the taxability of the following:

(i) Option granted to an employee.

(ii) Disposal of the option to acquire shares under the employee share scheme.

(iii) Shares issued to an employee under the option that are subject to restriction on transfer.

Explain the timing and valuation aspects in respect of the above, with reference to the Income Tax Ordinance, 2001. (9)

(Q.3 (b) March 2008)

Question-5

Mr. Waseem received an amount of Rs.50,000 as arrears of salary pertaining to the tax year 2011 in the tax year 2012. Discuss the options available with Mr. Waseem under the Income Tax Ordinance, 2001 and what matters should he consider in deciding the best option. (4)

(Q.2 (b) March 2008)

Question-6

State the provisions of Income Tax Ordinance, 2001 relating to foreign-source salary of resident individuals. (3)

(Q.6 (a) March 2014)

Question-7

Munir resigned from his employment with Ali Industries Limited (AIL) with effect from 31 December 2014. He received following amounts in final settlement:

- Rs.150,000 as Leave Encashment.
- Rs.4,000,000 under a Golden Handshake Scheme.

Munir had received a salary of Rs. 350,000 per month for a period of six months upto December 2014. His taxable income and tax liability during the preceding five tax years were as under:

Tax year	2010	2011	2012	2013	2014
Total taxable income (Rs)	2,000,000	2,450,000	2,700,000	3,100,000	3,650,000
Total tax paid	90,000	100,000	273,000	130,000	185,000

Required:

As a tax consultant, advise Munir about the amount of income tax payable by him for the tax year 2015, under the Income Tax Ordinance, 2001. (06)

(Q.3 March 2015)

Question-8

Under the provisions of the Income Tax Ordinance, 2001 compute taxable income or loss, under the correct head of income for tax year 2017, in following case:

Under an employee share scheme, 30,000 shares of Dawood Limited were issued to Qamar, on 1 August 2013 for Rs. 30 each. According to the scheme, he was not allowed to sell/transfer the shares before completion of three years from the date of issue. The face value of each share is Rs. 10 per share. Fair market value of each share on different dates was as follows:

1 August 2013	30 June 2016	31 July 2016
Rs. 40	Rs. 30	Rs. 50

He sold 10,000 shares on 31 May 2017 for Rs. 65 per share. **(04)**

(Q.3(a)September 2017)

Question-9

Under the provisions of the Income Tax Ordinance, 2001 compute taxable income or loss under correct head of income for tax year 20X8, in the following case:

Hasrat has been working as Director HR in Shakir Limited (SL) for many years. During the tax year 20X8 he received basic salary of Rs. 6 million. SL also contributed Rs. 50,000 per month towards a recognized provident fund. An equal amount was contributed by Hasrat. Interest income of Rs. 3,391,000 at the rate of 20% of accumulated balance of the fund was credited to Hasrat's account. **(04)**

(Q.2(c) March 2018)

Question-10

Sajid retired from Sun Chemicals Limited (SCL) as a marketing manager with effect from 31 December 2019. He received the following amounts in final settlement from SCL:

(i) Leave encashment of Rs. 600,000.

(ii) Rs. 4,000,000 from unapproved provident fund. 50% of this amount was contributed by Sajid.

(iii) Un-approved gratuity of Rs. 2,500,000.

He also acquired the vehicle, provided to him by SCL, at accounting written down value of Rs. 500,000. The market value of the vehicle at the time of retirement was Rs.2,000,000.

Required:

Under the Income Tax Ordinance, 2001 and Rules made thereunder, discuss the tax treatment of the above benefits received by Sajid on retirement. **(04)**

(Q.5 (b) March 2020)

Question-11

Briefly explain the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder relating to interest free loan provided by an employer to its employee for marriage of his/her daughter. **(02)**

(Q.4(b)(i) March 2021)

Question-12

On 31 December 20X1, Dr. Jamal resigned from his employment with General Hospital Limited. In January 20X2, he received following amounts in final settlement:

- Rs. 600,000 as leave encashment.
- Rs. 8,510,000 from recognised provident fund.
- Rs. 1,300,000 and Rs. 1,700,000 as salary arrears relating to tax year 20W9 and 20X0 respectively.

Dr. Jamal had received a monthly salary of Rs. 500,000 from July 20X1 to December 20X1. His taxable income and tax liability during the preceding four tax years were as under:

Tax year	20W8	20W9	20X0	20X1
Total taxable income (Rs.)	2,800,000	3,200,000	3,800,000	4,800,000
Total tax paid (Rs.)	359,500	404,500	300,000	630,000

Required: As a tax consultant, advise Dr. Jamal about the amount of income tax payable by him for the tax year 20X2, under the Income Tax Ordinance, 2001. **(07)**

(Q.1(a) March 2021)

ICAP PAST PAPER SOLUTIONS

Answer-1

(1) Any foreign-source salary received by a resident individual shall be exempt from tax if the individual has paid foreign income tax in respect of the salary.

(2) A resident individual shall be treated as having paid foreign income tax in respect of foreign- source salary if tax has been withheld from the salary by the individual's employ errand paid to the revenue authority of the foreign country in which the employment was exercised. [S.102]

Answer-2

An employee who has received an amount in respect of golden hand shake in a tax year may, by notice in writing to the Commissioner, elect for the amount to be taxed at the rate computed as per following formula, namely:– [S.12(6)]

$$A/B\%$$

where –

A is the total tax paid or payable by the employee on the employee's **taxable income** for the three preceding tax years; and

B is the employee's taxable income for the three preceding tax years.

Answer-3

i) 10% of the fair market value of the motor vehicle at the commencement of the lease will be added in the salary income.

ii) Medical allowance is exempt upto 10% of basic salary, so in the given scenario whole amount is exempt. [S.39]

Answer-4

i) The value of a right or option to acquire shares under an employee share scheme granted to an employee shall not be chargeable to tax. [S.14(1)]

ii) Where, in a tax year, an employee disposes of a right or option to acquire shares under an employee share scheme, the amount chargeable to tax to the employee under the head "Salary" for that year shall include the amount of any gain made on the disposal computed in accordance with the following formula, namely:– [S.14(5)]

$$A-B$$

where –

A is the consideration received for the disposal of the right or option; and

B is the employee's cost in respect of the right or option.

iii) Where shares issued to an employee under an employee share scheme are subject to a restriction on the transfer of the shares -

(a) no amount shall be chargeable to tax to the employee under the head "Salary" until the earlier of –

(i) the time the employee has a free right to transfer the shares; or

(ii) the time the employee disposes of the shares; and

(b) the amount chargeable to tax to the employee shall be the fair market value of the shares at the time the employee has a free right to transfer the shares or disposes of the shares, as the case may be, as reduced by any consideration given by the employee for the shares including any amount given as consideration for the grant of a right or option to acquire the shares. [S.14(3)]

Answer-5

Option 1

Option 1 is that he can treat this amount as income of TY 2012 because it is received in this year.

Option 2

2nd option is that if Mr. Waseem's income due to receipt of arrears the employee is chargeable at higher rates of tax than would have been applicable if the amount had been paid to him in the tax year in which the services were rendered, he may, by notice in writing to the Commissioner, elect for the amount to be taxed at the rates of tax that would have been applicable if the salary had been paid to him in the tax year (TY 2009) in which the services were rendered. [S.12(7)]

Answer-6

Any foreign-source salary received by a resident individual shall be exempt from tax if the individual has paid foreign income tax on the salary.

It will be assumed that resident individual has paid foreign income tax on foreign-source salary if tax has been withheld from the salary by the individual's employer and paid to the revenue authority of the foreign country. [S.102]

Answer-7

Based on following calculations Mr. Munir should treat the golden hand shake as separate block (Option-2) as it would result in net saving of Rs. 544,950 (951,250 – 406,300)

Mr. Munir
Taxable Income and tax thereon
TY 2015

Option-1 Treating golden hand shake in normal way

Basic Salary [S.12(2)(a)]	(350,000 x 6)	2,100,000
Leave Encashment [S.12(2)(a)]		150,000
Golden hand shake[S.12(2)(e)(iii)]		4,000,000
Taxable income		6,250,000
Tax (Table 2)	(670,000 + 22.5% x 1,250,000)	951,250

Option-2 Treating golden hand shake as separate block

Basic Salary [S.12(2)(a)]	(350,000 x 6)	2,100,000
Leave Encashment [S.12(2)(a)]		150,000
Golden hand shake[S.12(2)(e)(iii)]		4,000,000
Total income		6,250,000
Less: Golden handshake – taxable separately		(4,000,000)
Taxable income – under NTR		2,250,000
Tax on above (Table 2)	(90,000 + 15% x 450,000)	157,500
Add: Tax on golden hand shake	(4,000,000 x 6.22%)	248,800
		406,300

	Taxable income	Tax
TY 2014	3,650,000	185,000
TY 2013	3,100,000	130,000
TY 2012	2,700,000	273,000
	9,450,000	588,000

Rate (588,000 / 9,450,000) 6.22%

Answer-8

TY 2017

Income from salary (Free right to transfer the shares acquired on 31 July 2016)

FMV of shares on receiving free right	(30,000 x 50)	1,500,000
Less: Consideration given by employee	(30,000 x 30)	(900,000)
Income from salary		**600,000**

Income from capital gain (Disposal of Shares on 31 May 2017)

Consideration received	(65 x 10,000)		650,000
Less:			
Cost of shares	(30 x 10,000)	300,000	
Amount charged under the head salary	(600,000/30,000 x 10,000)	200,000	(500,000)
Income from capital gain			**150,000**

Answer-9

		Rs(000)	Rs(000)
Income from salary			
Basic Salary			6,000
Employee Contribution (ignored being already included in above salary)			-
Employer Contribution (50 x 12)		600	
Less: Exempt upto lower of:			
- 1/10 of Basic Salary (6,000 x 10%) = 600			
- 150		(150)	450
Interest on provident fund		3,391	
Less: Exempt upto higher of:			
- 1/3 of Basic Salary (6,000 / 3)	2,000		
- Interest @ 16% ((3,391/20) x 16)	2,713	(2,713)	678
Income from Salary			7,128

Answer-10

Leave encashment

Leave encashment of Rs. 600,000 is taxable under the head salary.

Unapproved provident fund

Rs. 4,000,000 from unapproved provident fund includes Rs. 2,000,000 contributed by Sajid which is an employee contribution so no treatment is required as the amount is paid from salary. Remaining Rs. 200,000 probably comprise of principal and interest which is now taxable on receipt basis under the head income from salary.

Unapproved gratuity

Unapproved gratuity of Rs. 2,500,000 will be exempt upto lower of 50% of the amount receivable or Rs. 75,000. As Rs. 75,000 is lower than 50% of amount receivable of Rs. 1,250,000 (Rs. 2,500,000 x 50%), the amount to be included in taxable income is Rs. 2,425,000 (2,500,000 – 75,000).

Transfer of property

Where a property is transferred, salary shall include fair market value of property at the time of transfer less amount paid by employee to the employer. As fair market value of vehicle at the time of transfer is Rs. 2,000,000 and the amount transferred by Sajid to employer is Rs. 500,000, the amount to be included in taxable income will be Rs. 1,500,000 (2,000,000 – 500,000).[S.13(11)]

Answer-11

Where a loan is provided by an employer to an employee and **no profit (interest) on loan is paid by an employee** the salary shall include **interest on loan calculated at bench mark rate.**

However nothing will be added in the salary income if:

- the loan is upto Rs. 1,000,000.
- the interest benefit is arising because employee has waived the interest to employer when employee had provided the loan to the employer.

Answer-12

Salary taxation on receipt basis

Income from salary – 20X2	
Salary (500,000 x 6)	3,000,000
Leave encashment	600,000
Recognised provident fund (Accumulated balance)	-
Arrears for 20W9 & 20X0 (1,300,000 + 1,700,000)	3,000,000
Taxable Income	6,600,000
Tax liability [670,000 + (22.5% x 1,600,0000]	1,030,000

Salary taxation on accrual basis

Income from salary – 20X2		
Salary (500,000 x 6)		3,000,000
Leave encashment		600,000
Recognised provident fund (Accumulated balance)		-
Taxable income		3,600,000
Tax liability [370,000 + (20% x 100,000]	(A)	390,000
Income from salary – 20X0		
As per question		3,800,000
Received in TY 20X2		1,700,000
Taxable income		5,500,000
Tax liability [670,000 + (22.5% x 500,000]	(B)	782,500
Income from salary – 20W9		
As per question		3,200,000
Received in TY 20X2		1,300,000
Taxable income		4,500,000
Tax liability [370,000 + (20% x 1,000,000]	(C)	570,000

Conclusion

If I use **accrual basis** (20X2 + 20X0 + 20W9)	(390,000 + 782,500 + 570,000)	1,742,500
If I use **receipt basis** (20X2 + 20X0 + 20W9)	(1,030,000 + 300,000 + 404,500)	1,734,500
Tax savings (1,742,500 – 1,734,500)		8,000

Jamal should select salary taxation on receipt basis as it results in tax savings of Rs. 8,000

PRACTICE QUESTIONS

Question-1

Ms Fauzia, a resident in Lahore, Pakistan, has worked for Star Products (Pvt) Ltd (SPPL) for many years. For the year ended 30 June 2012, her income/receipts are as detailed below:

(a) Her basic salary during the year was Rs. 100,000 per month. Other perquisites given in cash or kind were as below:

- (i) A medical allowance at 15% of her basic salary. The terms of her employment do not provide for free medical treatment or hospitalisation or any reimbursement of such expenses.
- (ii) SPPL provided her with a car for official and personal use. SPPL had obtained the car by way of a finance lease and its fair market value at the time of the lease was Rs. 1,600,000. The lease rentals paid during the year were Rs. 200,000.
- (iii) SPPL reimbursed her Rs. 20,000 per month, being the school fees of her child.
- (iv) SPPL gave her a loan of Rs. 500,000 on 1 July 2011 at 5% mark-up. Ms Fauzia, however, waives the interest on her account with SPPL.
- (v) SPPL paid her Rs.100,000 in lieu of her unavailed recreational leaves.
- (vi) She won the best employee award of SPPL in the form of a laptop having a fair market value of Rs. 140,000.
- (vii) Due to the escalation of food prices, a lump sum amount of Rs. 50,000 was paid to her in June 2012.
- (viii) Zakat of Rs. 340,000 was paid under the Zakat and Ushr Ordinance, 1980.

Additional information about employment

- (i) Ms Fauzia paid Rs. 50,000 for attending a training workshop to equip her with the latest audit techniques. SPPL did not reimburse this amount.
- (ii) SPPL deducted tax of Rs. 30,000 from her salary paid during the year.

Required:

Compute Ms Fauzia's taxable income and her total tax payable for the tax year 2012.

Question-2

The following information is provided by Mr. Qureshi.

(1) Qureshi, a citizen of Pakistan, retired from the services of XYZ Private Ltd (XYZ) on 29 June 2007. On retirement, Qureshi was eligible to receive the following from XYZ:

- (i) A monthly pension of Rs. 20,000 payable from 1 July 2007.
- (ii) Rs. 100,000 in lieu of unavailed privileged leave.
- (iii) Rs. 450,000 as a gratuity. The gratuity payable was under a gratuity scheme of XYZ, which is applicable to all the company's employees. The gratuity scheme has been approved by the Federal Board of Revenue.

The pension is deposited at the end of each month into Qureshi's bank account. The amounts for the leave pay (leave encashment) and gratuity were paid by XYZ to Qureshi on 5 July 2007. No taxes were deducted by XYZ from the above payments.

(2) Qureshi commenced employment with Superior Steel Ltd (SSL) on 1 July 2007 as the factory accountant. In accordance with the terms of his employment the following remuneration and benefits were received by Qureshi for the year ended 30 June 2008:

- (i) A basic monthly salary of Rs. 200,000.
- (ii) Monthly allowances of Rs. 20,000 for housing and Rs. 30,000 each for utilities and medical treatment.
- (iii) A company maintained motor car for his business and private use.
- (iv) Reimbursement of all medical treatment or hospitalisation charges for Qureshi and his wife.

(3) As a policy matter of SSL, which is applicable to all employees, the basic salary for the month is deposited into each employee's bank account on the first working day of the following month. The monthly allowances are to be collected by the employees from the cashier on the last working day of each month.

(4) (i) In order to provide the benefit of a car to Qureshi, a new Toyota Saloon was taken on lease by SSL on 1 August 2007 from an approved leasing company, for an annual lease rental of Rs. 400,000 payable for four years. If the car had been purchased outright by SSL, the cash price would have been Rs. 1,200,000.

(ii) For the year ended 30 June 2008, SSL paid Rs. 210,000 as hospitalisation charges for the treatment of Qureshi's wife.

(iii) During the month of June 2008, Qureshi was on vacation. On resuming his duties on 7 July 2008, he collected his monthly allowances from the cashier for the month of June 2008.

(5) Due to the constantly fluctuating power supply, SSL agreed to supply electricity to the apartment rented by Qureshi from the factory generator. The electricity units consumed during the year ended 30 June 2008 as per the meter installed in the apartment, if purchased from an independent power company, would have cost Rs. 123,800.

(6) Qureshi paid Rs. 15,000 as Zakat under the Zakat and Ushr Ordinance, 1980 in the year ended 30 June 2008.

Required:
Compute the taxable income of Mr. Qureshi for the relevant tax year under the appropriate heads of income.

Question-3

For the purpose of this question, you should assume that today's date is 15 July 2009.
The following information is furnished to you by Mr. Moshin (M), a citizen of Pakistan, for his accounting year ended 30 June 2009.

(1) M joined the JMC Medical Centre Karachi (JMC) from 1 August 2008 on a five-month contract. His terms of employment provided for the following:
- (i) A basic salary of Rs. 300,000 per month.
- (ii) A commission equal to 20% of the gross consultancy fees collected by JMC in respect of the patients referred to M.
- (iii) Monthly cash allowances of:
  - 45% of basic salary for rent; and
  - 10% of basic salary for medical.
- (iv) JMC and M each to contribute 8% of M's basic salary to the JMC Employees Provident Fund. The fund is not recognised by the Commissioner.
- (v) Free medical treatment for M and his wife.

(2) The consultancy fees, collected by JMC for the period from 1 August 2008 to 31 December 2008 from the patients referred to M, was Rs. 3,900,000.

(3) The following amounts were also received by M in the tax year 2009:

(i)	From the JMC Employees Provident Fund (Fund). Rs. 120,000 was contributed by JMC and Rs. 120,000 was deducted from M's salary.	240,000
(ii)	Consideration received for vacating the possession of a building occupied by him M had paid Rs. 600,000 to the previous tenant to acquire the possession of the building.	1,000,000

(4) On 1 March 2009, on the occasion of Eid, JMC paid all their employees one month's basic salary as a bonus. JMC informed M, that though he was no longer their employee, as a special case, he would be paid a bonus of Rs. 150,000. M informed JMC that the Rs. 150,000 should not be paid to him but should be paid to the Poor Patients Unit managed by JMC. JMC paid the Rs. 150,000 to the Poor Patients Unit on 31 March 2009.

(5) M paid Rs. 27,000 as Zakat under the Zakat and Ushr Ordinance, 1980 in the year ended 30 June 2009.

Required:
Compute the taxable income of Mr. Moshin under the appropriate heads of income for the tax year 2009.

Question-4

The following information is furnished to you by Mr. Cyrus Banaji for his accounting year ended 30 June 2007.

(1) On 31 December 2006, Cyrus, a citizen of Pakistan, retired from the employment of the Karachi branch of ABC Limited (ABC), a company incorporated under the law of a country outside Pakistan. Cyrus has been in the employment of ABC since 1 January 1990 and on retirement he received:

- Rs. 1,000,000 from ABC as a gratuity. The amount received was not from any gratuity fund approved by the Commissioner or a gratuity scheme approved by the Federal Board of Revenue.

- Rs. 9,000,000 from the ABC Employees Provident Fund being the accumulated balance in his account of the fund. The fund has been recognised by the Commissioner.

(2) On 1 June 2007 (on which date Cyrus was no longer in the employment of ABC), DEF Ltd Singapore transferred the equivalent of Rs. 4,000,000 in US Dollars to Cyrus's bank account in Singapore. The payment was in consideration of Cyrus consenting to a restrictive covenant restraining him from entering into employment with any competitor company of ABC for a period of five years. DEF Ltd Singapore is an associate company of ABC.

(3) The terms of employment of Cyrus with ABC provided for the following:

(i) A basic salary of Rs. 250,000 per month.

(ii) Monthly cash allowances of:
- Rs. 25,000 for utilities
- Rs. 45,000 for house rent assistance

(iii) A company maintained car (purchased for Rs. 2,000,000 on 1 January 2003) for Cyrus's personal and business use.

(4) Under the ABC car policy, a retiring employee, with at least three years' service, has the option to purchase the company maintained car used by that employee at the accounting written down value (WDV) of the car. Cyrus exercised this option and purchased the car at its WDV of Rs. 100,000 on 30 December 2006. He sold the car on 1 January 2007 for Rs. 250,000.

Required:

Compute the taxable income of Mr. Cyrus Banaji for the relevant tax year.

PRACTICE QUESTIONS' SOLUTION

Answer-1

				Rs.
Income from salary				
Basic salary	(100,000 x 12)	[S.12(2) (a)]		1,200,000
Medical allowance	(15% x 1,200,000)		180,000	
Less: Exempt up to 10% of 1,200,000		[2nd Sch. Cl. 139]	(120,000)	60,000
Perquisite representing car	(1,600,000 x 5%)	[S.13(3)]		80,000
Reimbursement of child's school fee	(20,000 x 12)	[S.12(2)(d)]		240,000
Encashment of recreational leave		[S.12(2)(a)]		100,000
Fair market value of laptop		[S. 13(11)]		140,000
Lump sum amount for food				50,000
Total income				1,870,000
Less: Zakat Paid				(340,000)
Taxable income				**1,530,000**
Tax Liability (Table 2)	(30,000 + 10% x 330,000)			63,000
Less: Tax deducted u/s 149				(30,000)
Tax Payable/(Refundable)				**33,000**

items not included in the computation of taxable income

(i) As Ms. Fauzia waives the interest on her account with SPPL therefore the interest benefit on loan provided to her at lower than the benchmark rate will not be included in calculating taxable income. [S.13(7)]

(ii) No deduction is allowed under the head "Income from Salary" therefore Rs. 50,000 for training workshop will be ignored.

Answer-2

(a)

Mr Qureshi
Taxable Income and Tax Thereon
Tax year 2008

			Rs.
Computation of taxable income			
Income from Salary			
From XYZ Private Ltd:			
Pension Rs. 240,000 (Rs. 20,000 x 12 months) – exempt from tax		(Note 1) [2nd Sch. Cl. 8]	-
Payment in lieu of unavailed leave	[S.12(2) (a)]		100,000
Gratuity (450,000 – 300,000)	[2nd Sch. Cl. 13(iii)]		150,000
From Superior Steel Ltd:			
Basic salary – Rs. 200,000 x 11 months	[S.12(2)(a)]		2,200,000
Allowances		(Note 2)	
– Housing – Rs. 20,000 x 12 months	[S.12(2)(c)]		240,000
– Utilities – Rs. 30,000 x 12 months	[S.12(2)(c)]		360,000
– Medical – Rs. 30,000 x 12 months	[S.12(2)(c)] (taxable as reimbursement is as per terms)		360,000
Benefit of company maintained car (5% of Rs. 1,200,000) x 11/12	[S.13(3)]		55,000
Benefit of free hospitalisation – Rs. 210,000 – exempt from tax		(Note 3) [2nd Sch. Cl.139]	–
Free electricity	[S.13(6)]		123,800
Total income			3,588,800
Less: Zakat paid	[S.60]		(15,000)
Taxable income			3,573,800

Notes referred to in the computation of income and tax payable

(1) The Rs. 240,000 (Rs. 20,000 x 12) received by Qureshi from XYZ Private Ltd (XYZ) as his pension for the twelve months from July 2007 to June 2008 is his salary income for the tax year 2008and is exempt since he is a citizen of Pakistan. [2nd Sch. Cl. 8]

(2) A person is treated as having received an amount, if it is made available to the person. The allowances were thus made available to Qureshi in June 2008 and are therefore treated as having been received by him in June 2008. [S. 69]

(3) Rs. 210,000 paid by SSL for the hospitalisation charges for the treatment of Mrs Qureshi is exempt from tax as this benefit is in accordance with the terms of employment of Qureshi. It is assumed that the national tax number of the hospital is available and SSL has certified and attested the hospital bill. [2nd Sch. Cl. 139]

Answer-3

Mr. Moshin
Taxable Income and Tax Thereon
Tax year 2009

			Rs.
Computation of taxable income			
Income from salary			
From JMC Medical Centre (JMC):			
Basic salary for five months	[S. 12(2) (a)]	(300,000 x 5)	1,500,000
Commission	[S. 12 (2) (a)]	(20% of Rs. 3,900,000)	780,000
Rent allowance - 45% of Rs. 1,500,000	[S. 12 (2) (c)]		675,000
Medical allowance - 10% of Rs. 1,500,000		(Note 1)	150,000
Contribution of JMC to the employees provident fund		(Note 2)	120,000
Bonus	[S.12 (2)(a)]	(Note 3)	150,000
			3,375,000
Income from other sources			
Consideration for vacating rented building	[S.39(1) (k)]	(1,000,000-600,000)/10	40,000
Total income			3,415,000
Less: Zakat	[S.60]		(27,000)
Taxable income			3,388,000

Notes referred to in the computation of income and tax payable

(1) M's terms of employment provide for free medical treatment. Therefore, the medical allowance is fully taxable.

(2) As no interest is given so only employer contribution is taxable.

(3) An amount is treated as received by an employee from any employment regardless of whether the amount is paid or provided by a past employer or a prospective employer. Furthermore, a person is treated as having received an amount, inter alia, if the amount is applied on behalf of the person, at the instructions of the person.

Answer-4

Mr Cyrus Banaji
Taxable Income and Tax Thereon
Tax year 2007

				Rs.
Income from Salary				
From ABC:				
Consideration for agreeing to a restrictive covenant [S.12(2)(e)(v)]				4,000,000
Gratuity	[2nd Sch. Cl. 13(ii)]		1,000,000	
Less: Exempt upto lower of: - 50% of 1,000,000 - 75,000			(75,000)	925,000
Basic salary	[S.12(2)(a)]	(Rs. 250,000 × 6 months)		1,500,000
Cash allowances	[S.12(2)(c)]			
- Utilities		(Rs. 25,000 × 6 months)		150,000
- House rent		(Rs. 45,000 × 6 months)		270,000
Benefit of company maintained car	[S.13(3)]	(5% of Rs. 2,000,000) × 6/12		50,000
Benefit on purchase of car	[S. 13 (11)] (Note 2)	(250,000 – 100,000)		150,000
Taxable Income				7,045,000

Items not included in the computation of taxable income

(1) The accumulated balance due and becoming payable to an employee participating in a recognised provident fund is exempt from tax.

Notes referred to in the computation of taxable income and tax payable

(2) Where any asset is transferred by an employer to an employee, the amount chargeable is the fair market value (FMV) of the asset as reduced by any payment the employee. The car purchased by Cyrus for Rs. 100,000 was sold by him within two days of its acquisition for Rs. 250,000. It is, therefore a FMV of the car on the date of its transfer. Rs. 150,000 being the difference between the FMV (Rs. 250,000) and the payment made by Cyrus for the car (Rs. 100,000) is chargeable to tax as salary income. [S. 13(11)]

SCENERIO BASED QUESTIONS

Question-1

Explain whether the following amounts are chargeable/exempt in the hands of employee for TY 2016?

(i) Mr Ali worked for XYZ Co. He got retired on July 1, 2015 and from that date, company started paying monthly pension of Rs. 15,000. He got a new job on July 1, 2015 in BZ Ltd. which is an associate of XYZ Co.

(ii) Mr A received Rs. 505,000 interest free loan from employer in current year. In 2012 the employee also gave loan to employer which was also interest free.

(iii) Mr Daniyal is a citizen of Pakistan. He left Pakistan on June 1, 2016 and remained abroad and got employment in Dubai. He received Rs. 20,000 Dirham/ month. He didn't pay any tax there.

(iv) Mr Anjum is currently receiving two pensions. One of Rs. 40,000 from Izar Corporation and another pension of Rs 42,000 from Real Corporation.

Question-2

Explain whether the following amounts are chargeable/exempt in the hands of employee for TY 2016?

(i) Mr. Aqib worked as an employee for Foreign Newspaper and received $ 2,000 / month from there. Tax was properly deducted by foreign authorities. The current state bank rate is 1$= Rs. 101

(ii) Mr Udas won Best Executive Employee Award and presented with a laptop having Fair market value of Rs 150,000

(iii) Mr Asif is in need of vehicle for his home. His employer has some old vehicles which are used in business. He sold a Honda City to Mr Asif for Rs 800,000. The current market value of that vehicle was 1,000,000

(iv) Employer gave a loan of Rs 400,000 to Mr Udas @ 3%. However benchmark rate is 10%.

(v) Mr Aziz acquired a vehicle on lease for going to office. He pays Rs 20,000 as semi-annual lease payment and he has also incurred expenditure of Rs 3,000/month on petrol for going to office.

(vi) Mr. Umer is employee of Akif Ltd and also a sleeping partner in Q Associates. He received Rs. 120,000 from the firm.

SCENERIO BASED QUESTIONS' SOLUTION

Answer-1

(i) A pension received by a citizen of Pakistan from a former employer shall be exempt. However if person continues to work for the employer (or an associate of the employer) then it will be chargeable. Therefore Rs. 15,000/month pension is chargeable to tax.

(ii) As per S.13 nothing will be added in salary income if the interest benefit is arising because employee has waived the interest to employer when employee had provided the loan to the employer.

(iii) As per Section 51(2) where a citizen of Pakistan leaves Pakistan during a tax year and remains abroad during that tax year than salary income earned outside Pakistan during that year shall be exempt from tax. As per above provision nothing will be chargeable to tax in respect of foreign source salary income.

(iv) If a person receives more than one pension, then only higher pension will be exempt from tax. Therefore only 42,000 will be exempt from tax and Rs 40,000 will be chargeable to tax.

Answer-2

(i) As per S. 102 any foreign-source salary received by a resident individual shall be exempt if the individual has paid foreign income tax on salary.
As Mr Aqib has paid the tax on his foreign salary so nothing will be chargeable to tax.

(ii) As per S. 13(11) According to provision of law Where a property is transferred by an employer to an employee, salary shall include Fair market value of property at the time of transfer less amount paid by employee to the employer. So the fair value of laptop Rs. 150,000 will be chargeable to tax

(iii) As per S. 13(11) where a property is transferred by an employer to an employee, salary shall include fair value of property at the time of transfer less amount paid by employee to the employer. As per the above provision Rs. 200,000 will be chargeable to tax.

(iv) As per sec.13 nothing will be added in the salary income if the loan is upto Rs. 1,000,000, that's why nothing will be added in income as the amount of loan is Rs. 400,000.

(v) No deduction shall be allowed for an expense paid by an employee under the head "Salary". Therefore these expenses are not allowed as deduction under the head Income From Salary

(vi) The profit received from firm is not treated as Income from salary and it is not chargeable to tax under the head 'Income from salary".

OTHER QUESTIONS

Scenario	Treatment
a) If an employee has worked for 7 months and his basic salary is Rs. 50,000/month. Then what should be added while calculating the benefit for accommodation provided.	[S.13(12)]
b) If the loan is waived on February 28, 2011, what should be done with interest?	
c) Mr. Amir is working as technical manager in PTCL. PTCL owns 100% shares in Ufone. During the current year he was sent on special assignment in Ufone and the salary for this period was paid by Ufone. How it will be taxed?	
d) Under various provisions of law a taxpayer has been provided with two options to tax an amount. You are required to list down those provisions.	[S.12(6),(7)]
e) A person has opted to tax golden hand shake as separate block in respect of income earned in TY 2012. You are requested to inform him the procedure for availing this benefit	[S.12(6)]

LECTURE NOTES

Question-1

Moin is working as a Commercial Manager in an unlisted public company, for the past many years. He derived following emoluments during the tax year ended 30 June 2018:

	Rupees
Basic salary (per month)	250,000
Milk allowance (per month)	4,500
Housing allowance (per month)	25,000
Travel allowance (per month)	11,500

In addition to above, Moin was also provided with the following:

(i) Performance related bonus of Rs. 500,000. The bonus was however, paid to him on 5 July 2018.

(ii) Rs. 900,000 for signing a bond with employer. According to the bond he would not resign from his employment for 5 years.

(iii) A special allowance of Rs. 50,000 was paid to meet expenses necessarily to be incurred in the performance of his official duties (a special training program). Actual expenditure was Rs. 40,000.

(iv) Reimbursement of Rs. 20,000 in respect of telephone and internet charges. 20% of this amount was spent by Moin in performance of his official duties.

(v) He has been provided a company maintained 1600cc car which was used partly for official and partly for personal purposes. The employer has leased the car from a bank. The gross lease rentals payable over the period of lease of 3 years amount to Rs. 2,700,000. The fair market value of the car at the time of lease was Rs. 2,000,000. The total lease rentals paid by employer during the year amounted to Rs.900,000.

(vi) The services of a housekeeper are provided by employer. House servant salaries for the year paid by employer are Rs. 230,000 and Moin paid Rs. 40,000 to employer in this regard.

(vii) On 31 December 2017, he received a loan of Rs. 2,000,000 from employer. The loan carries a mark-up of 4% per annum. The prescribed benchmark rate is 10%.

(viii) Rs. 300,000 of above loan was waived by employer on June 30, 2018.

(ix) Moin obtained a loan of Rs. 350,000 from MCB bank for his daughter's marriage some years back. In the current year employer paid this amount to bank.

Required:

Under the provisions of Income Tax Ordinance, 2001 and rules made thereunder, compute taxable income and net tax payable by or refundable to Mr. Moin for the year ended 30 June 2018. (15)

Question-2

Mukarram is working as a Commercial Manager in Airmen Engineering Limited (AEL), an unlisted public company, for the past many years. He derived following emoluments during the tax year ended 30 June 20X5:

	Rupees
Basic salary (per month)	250,000
Travel allowance (per month)	11,500

In addition to above, Mukarram was also provided the following:

(i) A used company maintained car for both business and personal use. This car was provided to him on 1 July 20X4 in replacement of his previous car. This car was purchased three years ago at a price of Rs. 1,000,000. However, the fair market value of the car on 1 July 20X4 was Rs.800,000. On 1 September 20X4, in accordance with the terms of his employment, AEL transferred the previous car to Mukarram at book value. The market value of the car at the time of transfer was Rs. 400,000 whereas its book value was Rs. 200,000. On 1 June 20X5, Mukarram sold this car to his neighbour at a price of Rs. 350,000.

(ii) Two air-conditioners and a washing machine for use at home. The combined book value of these appliances was Rs. 300,000. The appliances are returnable to AEL after three years' time. AEL charged 10% depreciation on these appliances.

(iii) On 1 January 20X5 AEL sold an item of inventory to Mukarram for Rs. 12,000. The net realizable value of the item of inventory at the end of 1 January 20X5 and 30 June 20X5 was Rs.22,000 and Rs. 24,000 respectively. AEL had acquired it in July 20X4 at a cost of Rs. 35,000.

Required:

Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, compute the taxable income of Mukarram for tax year 20X5.

INCOME FROM BUSINESS

8

1. Income from business [Sec. 18]
2. Deductions in computing income chargeable under the head "Income from Business" [Sec. 20]
3. Deductions not allowed [Sec. 21]
4. Depreciation [Sec. 22]
5. Initial allowance [Sec.23]
6. First Year Allowance [Sec. 23A]
7. Accelerated depreciation to alternate energy projects [Sec. 23B]
8. Intangibles [Sec. 24]
9. Pre-commencement expenditure [Sec. 25]
10. Scientific research expenditure [Sec. 26]
11. Employee training and facilities [Sec. 27]
12. Bad debts [Sec. 29]
13. Method of accounting [Sec. 32]
14. Cash-basis accounting [Sec. 33]
15. Accrual-basis accounting [Sec. 34]
16. Stock-in-trade [Sec. 35]
17. Profit on debt, financial costs and lease payments [Sec. 28]
18. Disposal and acquisition of assets [Sec. 75]
19. Cost [Sec. 76]
20. Consideration received [Sec. 77]
21. Purchase of immoveable property in cash [Sec 75A]
22. Speculation business [Sec. 19]
23. Minimum tax on the income of certain persons [Sec. 113]

CHAPTER 8
INCOME FROM BUSINESS

Definition

"business" includes:

- any trade, commerce, manufacture, profession, vocation or
- adventure or concern in the nature of trade, commerce, manufacture, profession or vocation,

but does not include employment;

Before staring we should know some basics:

- Income From Business
  - Incomes
    - Chargeable
    - Exempt
  - Deductions
    - Allowed
    - Not allowed

Distinction of business with employment

Business is an activity with the objective of earning profits. Income from illegal business is also taxable. There is a clear distinction between the income from business and employment. Following tests were used to decide whether activity was business or employment.

(a) Whether the taxpayer (assesse) is doing his own work or is working for other.
(b) If taxpayer is working for number of persons, it indicates that the he is carrying on a business.
(c) If the work is done by a Company or a Firm, it is a business.
(d) If taxpayer is dealing with his own goods/services (independently) it is business.

Income from business [Sec. 18]

(1) The following incomes,(other than exempt income and incomes falling under final tax taxation), shall be chargeable under the head "Income from Business":

(a) the profits and gains of any business carried on by a person at any time in the year;

> Only real profits are taxable. Therefore gain arising on revaluation of fixed assets/investments/foreign currency is not taxable.
> Similarly impairment loss is also ignored for tax purpose.

(b) income of any trade/professional association from the sale of goods or rendering of services to its members;

> For example, annual membership fee charged by ICAP to its members for rendering various services.

Explanation - Further it is clarified that income derived by co-operative societies from sale of goods, immoveable property or provision of services to its members is taxable.

(c) any income from the hire of tangible movable property;

> For example, rent a car business. Note: Rent of immoveable property falls under "Income from Property"

(d) the fair value of any benefit, derived during a past, present, or prospective business relationship.

Explanation.- The word 'benefit' includes any benefit from waiver of profit on debt or the debt itself

> It means that if a person has obtained a loan from bank and later on he is not able to repay and as a consequence of which bank waives the requirement to repay, then this benefit will be treated as income.

(e) management fee derived by a management company.

(2) Any profit on debt (interest income) derived by a person, where person's business is to derive such income, shall be chargeable under the head "Income from Business" instead of "Income from Other Sources".

> So, the income of the bank is taxable as "income from business" and not as "income from other sources".

"profit on a debt" whether payable or receivable, means –

(a) Any profit, interest, discount, premium payable due to a debt. However return of capital will not be a profit on debt; or

> Return of capital means dividend which is obviously not an interest.

(b) Any service fee on a debt, including fee paid for credit facility not utilized;
[Clause 46 of section 2]

"debt" means any amount owing, including accounts payable and the amounts owing under promissory notes, bills of exchange, debentures, etc. [Clause 15 of section 2]

(3) Where a lessor is a scheduled bank or a leasing company and they have leased out any asset, amount paid by the lessee to lessor shall be treated as "Income from Business" for lessor.

(4) Where any mutual Venture Capital Fund distributes interest income to any bank it will be chargeable under the head "Income from Business" instead of "Income from Other Sources".

Here the word distribution refers to the dividend. Therefore dividend received by a bank from mutual fund's interest income is treated as income from business of bank and it is not considered as dividend.

Question
Explain the tax treatment of profit on debt in various situations?
Answer
Refer S. 18 (2), (3) and (4)

Deductions in computing income chargeable under the head "Income from Business" [Sec. 20]

(1) In computing "Income from Business", a deduction shall be allowed for any expenditure incurred wholly and exclusively for business.

EXAMPLE
Mr. Amjad has obtained loan from bank for the purpose of purchasing a new car for personal use. However he used the loan for the purpose of purchasing some furniture for his shop. He cannot claim the deduction because loan is not exclusively obtained for the purpose of acquiring business assets.

(1A) If a person uses animals for business, not as stock and animals have died or become permanently useless, then sale proceeds on disposal of carcasses/animals less actual cost of animal will be allowed as deduction.

Explanation:
Carcass in this context means dead body. This provision deals with the persons who have animals for the purpose of getting milk from them.

Example
Mr. Kashif is in the business of selling fresh milk. . Two of the cows in fleet are not producing milk as per the, so he has decided to sell these cows. The consideration received by him is Rs. 20,000 per cow. Three years back he had purchased them for Rs. 50,000 per cow. Now Rs. 60,000 ((50,000-20,000) x 2 cows) will be allowed as deduction under the head income from business in the year of disposal.

(2) Where depreciable or an intangible asset is purchased with a useful life of more than 1 year the person must depreciate or amortise it.

(3) A deduction will be allowed for any expense incurred by an amalgamated company on:
- legal and financial advisory services and
- other administrative cost

relating to planning and implementation of amalgamation.

Deductions not allowed [Sec. 21]

Following deductions will not be allowed under the head "Income from Business"-

(a) any cess, rate or tax paid by the person in:
- Pakistan or
- a foreign country

that is paid on the profits of the business or is calculated as a percentage of profit;

1. It means that Pakistani income tax and foreign income tax is not allowed as deduction.
2. If a taxpayer cannot charge (recover) sales tax/federal excise duty from his customer it is allowed as deduction.

Example-1

Following is the detail of taxes paid by Lite Ltd. for the purpose of his business:

Property tax		20,000
Income tax -	In Pakistan	15,000
-	In Foreign country	12,000
Annual token tax on fleet of cars owned by it		1,000

Which of the above shall be allowed as deduction?

Solution:

Only property tax and token tax shall be allowed as a deduction because they are not based on profits and gains of business.

(b) tax deducted from an amount earned by the person;

(c) any expenditure from which the person is required to collect or deduct tax. However deduction will be allowed if the person has deducted and paid the tax as required by the law;

The disallowance in respect of purchase of raw material and finished goods shall be upto 20% of purchases.

If the tax is recovered by tax authorities, it will be assumed as paid.

Normally a person is required to deduct tax on payment of salary, rent, brokerage/commission, profit on debt, payment to non-resident, payment for services.

Example

Azhar Ltd. has paid salaries to his employees amounting to Rs. 1,000,000 on which tax is not deducted. Azhar Ltd. cannot deduct salary expense in computing taxable income from business.

Question

J. has provided the following data relating to his business:

		Rs. In 000
Sales		5,000
Less:	Purchases – Raw Material	(1,000)
	Salaries	(300)
	Rent Expense	(150)
	Prize awarded to customers for sales promotion	(30)
Net Profit		**3,520**

J. has not withheld the tax on purchases amounting to Rs. 700,000. Further no tax was deducted on payments for rent and prizes.

Required: Calculate income from business?

Note: Your computation should start from sales figure.

Solution

Income from business

			Rs. in "000"
Sales			5,000
Less:	Purchases – R.M (Total as per question – Disallowed)	(1,000 – 200)	(800)
	Salaries		(300)
Taxable income			3,900

(W-1) Purchases disallowed

Lower of:

- Purchases on which tax is not deducted	700
- 20% of total purchases (1,000 x 20%)	200

(ca) commission paid/payable exceeding 0.2% of the gross amount of supplies (sales) for products listed in the 3rd Schedule of the Sales Tax Act, 1990,

However full commission will be allowed as deduction if person is appearing in Active Taxpayer List (ATL).

Question

Mr. Taimoor is selling the juice products listed in 3rd schedule of Sales tax Act, 1990:
He has provided you with the following details for TY 2020:

	Rs.
Sale	5,000
Commission	15

Calculate his income for TY 2020 assuming:

1) His name is appearing in ATL
2) His name is not appearing in ATL

Answer

1)

	Rs.
Sale	5,000
Less: Commission	(15)
	4,985

2)

		Rs.
Sale		5,000
Less: Commission (allowed lower of):		
- Actual	= 15	
- 0.2% of 5,000	= 10	(10)
		4,990

(d) entertainment expenditure exceeding such limits as may be prescribed;

Rule 10 of Income Tax Rules, 2002

Entertainment expenditure-

(1) A deduction for entertainment expenditure shall be allowed if the expenditure is incurred wholly and exclusively for the purposes of business and is-

(a) incurred outside Pakistan on entertainment for business transactions or where expenditure is allocated as head office expenditure;

(b) incurred in Pakistan on entertainment of foreign customers and suppliers;

(c) incurred on entertainment of customers at the person's business premises;

(d) incurred at a meeting of shareholders, agents, directors or employees; or

(e) incurred at the opening of branches.

(2) A deduction will be allowed where expenses is incurred on persons related directly to business.

(3) In this rule, "entertainment" means the provision of meals, refreshments, and reasonable leisure facilities in accordance with the traditions and norms of business in Pakistan.

(e) any contribution made by the person to a fund that is not:

- a recognized provident fund
- an approved pension fund,
- an approved superannuation fund, or
- an approved gratuity fund;

(f) contribution to any provident or other fund established for the benefit of employees, if the person has not made effective arrangements to secure that tax will be deducted (u/s 149) from any payments made by the fund.

Explanation(e) and (f)

- Any contribution made to a recognized provident fund, approved pension fund, approved superannuation fund, or approved gratuity fund shall be allowed as deduction to the taxpayer if he has made effective arrangements for the deduction of tax on payment made by fund..
- No deduction shall be allowed to a person for contributions made to unrecognized provident fund, unapproved pension fund, unapproved superannuation fund, or unapproved gratuity fund.

(g) any fine or penalty paid by the person for the violation of any law, rule or regulation;

> Fine penalties paid to Government such as penalty for not paying income tax or penalty for not fulfilling the requirements of Companies Act, 2017 are not allowed as deduction.
> However the penalty for not fulfilling a business contract will be a tax allowable expense because it is not a violation of any law, rule or regulation.

(h) any personal expenditures incurred by the person;

> It refers to drawings.

(i) any amount carried to a reserve fund or capitalized in any way;

(j) any profit on debt, brokerage, commission, salary or other remuneration paid by an association of persons to a member of the association;

(l) any expenditure for a transaction paid under a single account head whose total exceeds Rs. 250,000, however if the payment is made through following modes the deduction will be allowed:

- crossed cheque drawn on a bank
- crossed bank draft or pay order or
- any other crossed banking instrument showing transfer of amount from the business bank account of the taxpayer:

Online transfer of payment from the business account of the payer to the business account of payee as well as payments through credit card shall be treated as transactions through the banking channel, if the transaction is verifiable from the bank statements of the payer and the payee:

Above provision shall not apply in case of:

(a) expenditures not exceeding Rs. 25,000;

(b) expenditures on account of –

(i) utility bills;

(ii) freight charges;

(iii) travel fare;

(iv) postage; and

(v) payment of taxes, duties, fee, fines or any other statutory obligation;

Question: A company made all the below mentioned payments in cash. You are required to calculate the amount of deduction which will not be allowed under the head income from business?

Payment	Repair Expense	Rent expense	Stationery expense	Utility expense
1	18,000	24,000	42,000	115,000
2	19,000	24,000	33,000	120,000
3	40,000	24,000	46,000	122,000
4	10,000	24,000	24,000	118,000
5	20,000	24,000	34,000	126,000
6	13,500	24,000	36,000	12,000
7	18,000	24,000	43,000	13,000
8	-	24,000	-	-
9	-	24,000	-	-
10	-	24,000	-	-
11	-	24,000	-	-
Total	**138,500**	**264,000**	**258,000**	**626,000**

Answer: Following amounts will not be allowed as deduction		
Stationery	(42,000+33,000+46,000+ 34,000 + 36,000 + 43,000)	234,000

(m) any salary paid exceeding Rs. 25,000/month otherwise than by:
- a crossed cheque or
- direct transfer of funds to the employee's bank account

Question: A company made following payments to its employees. You are required to calculate the amount of deduction which will not be allowed under the head income from business?

Payment	Abu bakar	Umer	Usman	Ali
1	21,000	32,000	38,000	35,000
2	21,000	32,000	38,000	35,000
3	21,000	32,000	38,000	35,000
4	21,000	32,000	38,000	35,000
5	21,000	32,000	38,000	35,000
Total	**105,000**	**160,000**	**190,000**	**175,000**

As per the policy of company the monthly payment of salary below 34,000 is made in cash and other payments are being directly transferred to bank account of employee.

Answer: Following amounts will not be allowed as deduction

Umer	(32,000x5)	160,000

Example illustrating S.21 (c) and (m) To which employee the salary paid will be allowed as deduction?

Employee	Mr. A	Mr. B	Mr. C
Salary per month	60,000	70,000	80,000
Mode of payment	Cash	Cheque	Cheque
Tax deducted	Yes	No	Yes
Allowed as deduction?	No	No	Yes

(n) any expenditure paid of a capital nature. However depreciation or amortization deductions will be allowed.

(o) Any expenditure in respect of sales promotion, advertisement and publicity in excess of 10% of turnover paid by pharmaceutical manufacturers.

Example [S. 21(o)] Mr. Anjum a pharmaceutical manufacturers has provided the following details:

	Rs.
Sale	5,000
Advertisement	(800)
Salaries	(900)
	3,300

Calculate his income for TY 2020 assuming:
a) We start from sale
b) We start from profit

Answer

a) Income from business

	Rs.
Sale	5,000
Less: Advertisement	(500)
Salaries	(900)
	3,600

(W-1) Advertisement allowed Lower of:

- Actual	800
- 10% of sale (5,000 x 10%)	500

b) Income from business

	Rs.
Profit	3,300
Less: Advertisement Disallowed (Total – Allowed) (800 – 500)	300
	3,600

(W-1) Advertisement allowed lower of:

- Actual	800
- 10% of sale (5,000 x 10%)	500

(p) Any expenditure on account of utility bill in excess of prescribed limits.
(q) Any expenditure of industrial undertaking for sale made to a person who is not registered under Sales Tax Act, 1990. Formula is as below:

$$(A/B) \times C$$

Where-
A is deduction claimed;
B is the turnover for the tax year
C is sales (exclusive of sales tax and federal excise duty) made to a person who is not registered under the Sales Tax Act, 1990 where sales equal or exceed Rs. 100 million per person:

Disallowance shall not exceed 10% of total deductions claimed under this part:
The Board may, exempt persons from this clause.
This clause shall come into force from the first day of October 2020.

Question

Mr. X has provided the following data relating to his business:

	Rs. In million
Sales (480 million to registered, 110 million to Mr. A unregistered, 10 million to Mr. B unregistered)	600
Less: Expenses	(320)
Net Profit	280

Required: Calculate income from business?

Solution

Starting from sale

Income from business

		Rs. in "000"
Sales		600
Less: Expenses	(320 – 32)	(288)
Taxable income		312

(W-1) Expense disallowed

Lower of:

- 320/600x 110	59
- 10% of 320	32

Solution

Starting from profit

Income from business

	Rs. in "000"
Net profit	280
Add: Expense not allowed	32
Taxable income	312

(W-1) Expense disallowed

Lower of:

- 320/600x 110	59
- 10% of 320	32

Note:
Following amounts if included in expenses are not allowed by tax authorities:
1. Accounting depreciation/ accounting amortisation/ accounting loss on sale of assets/impairment loss/revaluation loss
2. Security deposit paid by lessee to lessor
3. Security deposit paid to utility companies
4. Charity paid to non-profit organization (However tax credit will be allowed)
5. Charity paid to institutes specified in Second schedule (However deductible allowance will be allowed)
6. Charity and Zakat paid to poor families and beggars etc.
7. Purchase of tangibles and intangibles (However initial allowance and tax depreciation in respect of tangibles and tax amortisation in respect of intangibles will be allowed)
8. Pre-commencement expenditure (However amortisation at the rate of 20% will be allowed)
9. Provision for doubtful debt

How to deal with different expenses if we start numerical from accounting profit:
Following is a list of different types of expenses and their tax treatment

Nature	- **Allowed in accounting** - **Allowed in tax**	- **Allowed in accounting** - **Not Allowed in tax**	- **Not Allowed in accounting** - **Allowed in tax**
Examples	1. Salaries paid after deduction of tax 2. Monthly salary of say Rs. 18,000 paid in cash 3. Fine not paid to government 4. Contribution to recognised provident fund 5. Property tax 6. Utility bills paid in cash 7. Payment of expenses through cross cheque.	1. Salaries paid without deduction of tax 2. Monthly salary of say Rs. 27,000 paid in cash 3. Fine paid to government 4. Contribution to un-recognised provident fund 5. Income tax 6. Accounting depreciation and amortization 7. Accounting loss on sale of fixed assets 8. Provision for bad debt	1. Tax depreciation and amortization 2. Initial allowance 3. Tax loss on sale of fixed assets
Tax treatment	**Ignore**	**Add**	**Deduct**

[Note: It is not an exhaustive list of expenses.]

How to deal with different expenses if we start numerical from sales figure:

Nature	- **Allowed in accounting** - **Allowed in tax**	- **Allowed in accounting** - **Not Allowed in tax**	- **Not Allowed in accounting** - **Allowed in tax**
Tax treatment	**Deduct**	**Ignore**	**Deduct**

Division III
Deductions: Special Provisions

Depreciation [Sec. 22]

1. Method to be used is written down value.
2. Residual value given in the question will be ignored.
3. If the asset is eligible depreciable asset, then in the first year initial allowance as well as normal depreciation will be charged and in subsequent years of use only normal depreciation will be charged.
4. If the asset is not an eligible depreciable asset, then in the first year and subsequent years of use only normal depreciation will be charged.

(15) In this section,-

"Depreciable asset" means any tangible movable property, immovable property (other than unimproved land), or structural improvement on immovable property, owned by a person that –

(a) has a normal useful life exceeding 1 year;

(b) is likely to lose value as a result of normal wear and tear, or obsolescence; and

(c) is used wholly or partly in deriving income from business,

but shall not include any property for which full cost of asset is allowed as deduction in the year of purchase; and **"structural improvement"** in relation to immovable property, includes any building, road, driveway, car park, railway line, bridge, tunnel, airport runway, canal, fence, water or sewerage pipes, drainage, landscaping or dam.

In case a depreciable asset is jointly owned by a taxpayer and an Islamic financial institution licensed by the SBP or SECP due to an arrangement of Musharika financing (or diminishing Musharika financing), the asset is considered as wholly owned by the taxpayer.

(1) A depreciation deduction shall be allowed on depreciable assets used by a person.

(2) The depreciation is calculated by applying the rate on opening WDV of the asset. Following are the rates:

Assets	**Rate of depreciation**
Buildings (All types)	10%
Furniture and fittings, Plant and machinery – general, Motor vehicles and ships, Technical and professional books	15%
Computers and allied items including printer, monitor and IT related plant and machinery	30%
Aircrafts and aero engines	30%

If a depreciable asset is used in the person's business for the first time in a tax year commencing on or after the 1st day of July 2020 depreciation deduction shall be reduced by 50%.

(5) The written down value at the beginning of the tax year shall be –

(a) in the year of acquisition, the cost less initial allowance; or

(b) in next years, the cost less total depreciation deductions (including any initial allowance).
Explanation: Where any building, furniture, plant or machinery is used in a business whose income is exempt, depreciation shall be allowed for the said tax year and after expiration of the exemption, WDV of asset shall be calculated after reducing total depreciation deductions (including any initial allowance).

(8) On disposal of a depreciable asset, no depreciation shall be allowed in the year of disposal and–

(a) if the consideration is greater than the WDV, the additional amount will be chargeable to tax.

(b) if the consideration is less than the WDV, the difference shall be allowed as a deduction.

If a depreciable asset is used in the person's business for the first time in a tax year commencing on or after the 1st day of July 2020 depreciation deduction equal to 50% of the rate shall be allowed in the year of disposal.

(3), (6) Where an asset is used partly in deriving income from business and partly for another use:

- the depreciation will be allowed on proportionate basis.
- the WDV of the asset shall be computed assuming asset is wholly used for business.

(9) Where an asset is used partly in deriving income from business and partly for another use, the WDV of the asset at the time of disposal shall be increased by the amount of deduction not allowed in the previous years.

(7) The total depreciation and initial allowance during ownership shall not exceed the cost of the asset.

(13) (a) the cost of passenger transport vehicle (not plying for hire) shall not exceed Rs. 2.5 million; Where the cost of passenger transport vehicle (not plying for hire) is restricted to Rs. 2,500,000, the consideration received on disposal shall be calculated as follows–

A x B/C

A is the amount received on disposal of the vehicle;
B Rs. 2,500,000; and
C is the actual cost of acquiring the vehicle. [S. 22(10)]

Example

BTL ltd. disposed one of its vehicles for Rs. 3,000,000 in tax year 2022. The vehicle was purchased in tax year 2021. Cost of the vehicle was Rs. 2,800,000. Compute the amount of taxable gain.

Solution

Consideration on disposal [3,000,000 x (2,500,000/2,800,000)]	2,678,571
Less: Tax Written down value on Disposal [W]	(2,139,062)
Taxable gain on disposal	539,509

Working

Tax Written down value (WDV)

Restricted cost (tax year 2021)	2,500,000
Less: Depreciation -Tax year 2021 (2,500,000 x 15% x 50%)	(187,500)
WDV (30.06.2021)	2,312,500
Less: Depreciation -Tax year 2022 (2,312,500 x 15% x 50%)	(173,438)
WDV at disposal	2,139,062

(b) the cost of immovable property or a structural improvement shall not include the cost of the land;

(c) an asset owned by a leasing company and leased to another person is treated as used in lessor's business;

The depreciation allowed to a leasing company shall be deducted only against lease rental income.

(d) if consideration received on the disposal of immovable property exceeds the cost, the consideration shall be treated as the cost.

Example

A company disposed off its factory building for Rs. 10,000,000. Cost of the building at the time of acquisition was Rs. 8,000,000 and written down value of the building at time of disposal is Rs. 6,500,000. Compute the gain/(loss) on disposal.

Solution

Consideration		10,000,000
Less: Tax Written down value:		
Cost	10,000,000	
Less: Accumulated depreciation (8 Mill- 6.5 Mill)	(1,500,000)	(8,500,000)
Taxable gain on disposal		1,500,000

(14) If a person exports or transfers out of Pakistan a depreciable asset used in Pakistan, it will be assumed that person has disposed of the asset for a consideration equal to the cost of the asset.

Example

Safi Ltd. exported its special plant and machinery to Safi overseas inc. in USA for Rs. 4,575,000. Cost to Safi Ltd was Rs. 3,958,000 and written down value at time of disposal was Rs. 2,657,000. Compute the gain/(loss) on disposal.

Solution

Consideration (Restricted to cost of asset)	3,958,000
Less: Tax Written down value (W)	(2,657,000)
Taxable gain on disposal	1,301,000

Following format is to be used in tax numerical for fixed assets:

		Rs.
Accounting profit		xxx
Add:	Accounting depreciation/accounting amortization	xxx
	Accounting loss on sale of fixed assets/intangibles	xxx
	Tax gain on sale of fixed assets/intangibles	xxx
Less:	Tax depreciation/ amortization	(xxx)
	Accounting gain on sale of fixed assets/intangibles	(xxx)
	Tax loss on sale of fixed assets/intangibles	(xxx)
Taxable income		Xxx

Exam Note: following are the rules for calculating tax depreciation depending on "date of purchase" of depreciable asset:

Date of purchase of Depreciable asset	Year of purchase	Year of disposal
Before 1-July-2020	Full year depreciation will be allowed	No depreciation will be allowed
On or after 1-July-2020	50% factor will be applied	50% factor will be applied

Initial allowance [Sec.23]

(5) In this section, "eligible depreciable asset" means a depreciable asset other than –

(a) road transport vehicle (however the vehicle plying for hire is an eligible depreciable asset);
(b) furniture, including fittings;
(c) plant or machinery that has been used previously in Pakistan; or
(d) plant or machinery for which full cost of asset is allowed as deduction in the year of purchase

Following are the examples of eligible depreciable asset (it should not be considered as an exhaustive list of eligible depreciable assets):

i) Newly purchased plant and machinery in Pakistan
ii) Used (second hand) or newly purchased plant and machinery from outside Pakistan
iii) Road transport vehicle which is plying for hire (If a company has provided cars to its employees it is a road transport vehicle and it will not be treated as an eligible depreciable asset)
iv) Computers

(1) If a person places an eligible depreciable asset in to service in Pakistan for the first time in a tax year a deduction will be allowed (hereinafter referred to as an "initial allowance") at 25% for plant and machinery on the cost of the asset. The asset should be used for the purpose of business.

The initial allowance deduction will be allowed within the later of:

- the first time the asset is used or
- the tax year in which commercial production is commenced.

Note: Initial allowance is fully allowed as deduction even if the asset is not wholly used in business.

(3) Section 76 shall determine the cost.

(4) The deduction allowed to a leasing company or a bank shall be deducted only against the lease rental income.

"Vehicles" are of 2 types

Type	Plying for hire	Not plying for hire
Example	Examples of plying for hire are: • Daewoo bus • New khan bus • A bus taking passengers from Lahore to Qasur	Examples of not plying for hire are: • Dawlance has provided a car to its sales manager • RISE has provided a car to a teacher teaching audit.
Tax treatment	• Initial allowance will be allowed • Cost will not be restricted to Rs. 2.5 million	• Initial allowance will not be allowed • Cost will be restricted to Rs. 2.5 million

Some practice questions for depreciation

Question-1 [S.22 (2)]
Mr. Umer purchased furniture on 13-May-2021 costing Rs. 50,000. Calculate depreciation for TY 2021, 2022, 2023.

Answer-1

	Rs.
Cost (13-May-2021)	50,000
Less: Depreciation (TY 2021) (50,000 x 15% x 50%)	(3,750)
WDV (30.6.2021)	46,250
Less: Depreciation (TY 2022) (46,250 x 15%)	(6,938)
WDV (30.6.2022)	39,312
Less: Depreciation (TY 2023) (39,312 x 15%)	(5,897)
WDV (30.6.2023)	33,415

Question-2
We purchased a building costing Rs. 425,000 on 15-May-2021. Building is sold for Rs. 200,000 on January 15, 2023. Calculate depreciation for the year 2021, 2022 and 2023 and also calculate tax gain/loss on disposal.

Answer-2

Cost (15-May-2021)		425,000
Less: Depreciation (TY 2021)	(425,000 x 10% x 50%)	(21,250)
WDV (30-Jun-2021)		403,750
Less: Depreciation (TY 2022)	(403,750 x 10%)	(40,375)
WDV (30-Jun-2022)		363,375
Less: Depreciation (TY 2023)	(363,375 x 10% x 50%)	(18,169)
WDV (at disposal)		345,206

Gain/loss on disposal of building

Consideration received	200,000
Less: Tax WDV	(345,206)
Tax loss on disposal	(145,206)

Question-3
We purchased a building for Rs. 425,000 on 13-May-21 building is used 70% in business and 30% personal. Building is sold for Rs. 200,000 in TY 2023. Calculate depreciation for the year ended 2021, 2022 and 2023 and calculate tax gain/loss on disposal.

Answer-3

		Rs.	Business (70%)	Private (30%)
Cost		425,000		
Less: Depreciation (TY 2021)	(425,000 x 10% x 50%)	(21,250)	14,875	6,375
WDV (30-Jun-2021)		403,750		
Less: Depreciation (TY 2022)	(403,750 x 10%)	(40,375)	28,263	12,112
WDV (30-Jun-2022)		363,375		
Less: Depreciation (TY 2023)	(363,375 x 10% x 50%)	(18,169)	12,718	5,451
WDV (30-Jun-2023)		345,206		

Gain/loss on disposal

	Rs.	Rs.
Consideration received		200,000
Less: Tax WDV	345,206	
Add: Depreciation not allowed		
2021	6,375	
2022	12,112	
2023	5,451	(369,144)
Loss on disposal		(169,144)

Question-4

Mr. Harris has purchased a building costing Rs. 4,675,000 on 1 October 2020. The building is disposed of in TY 2022.Calculate

a) Depreciation for TY 2021 and 2022; and

b) Tax gain/ (loss) on disposal if consideration for disposal is Rs. 7,000,000.

Answer-4

a)

Cost					4,675,000
Less:	Depreciation	(30.6.2021)	(4,675,000 x 10% x 50%)		(233,750)
WDV		(30.6.2021)			4,441,250
Less:	Depreciation	(30.6.2022)	(4,441,250 x 10% x 50%)		(222,063)
WDV		(30.6.2022)			4,219,187

b)

Consideration received			7,000,000
Less: Tax Written Down value			
Cost		7,000,000	
Less: Accumulated Depreciation (4,675,000 – 4,219,187)		(455,813)	(6,544,187)
Tax Gain			455,813

Question-5

Continuing from Q.4 Mr. Harris disposed of the building in TY 2022 for Rs. 2,000,000. Calculate gain/(loss)?

Answer-5

Consideration received	2,000,000
Less: Tax Written Down value	(4,219,187)
Tax loss	(2,219,187)

Question-6

Mr. Riaz has purchased a building costing Rs. 6,800,000 on 1 September 2020. Building is disposed of on 1 November 2021 for Rs. 6,600,000. Calculate depreciation for first 2 years of use and tax gain/loss on disposal.

Answer-6

Cost				6,800,000
Less:	Depreciation	(30.6.2021)	(6,800,000 x 10% x 50%)	(340,000)
WDV		(30.6.2021)		6,460,000
Less:	Depreciation	(30.6.2022)	(6,460,000 x 10% x 50%)	(323,000)
WDV				**6,137,000**

Gain/loss on disposal

Consideration	6,600,000
Less: Tax WDV	(6,137,000)
Gain	463,000

Question-7

Mr. Atif has acquired furniture costing Rs. 300,000 on 1 February 2021. After using it for 1 year it is exported on 1 February 2022 to Nepal against a consideration of Rs. 70,000. Calculate gain/(loss)?

Answer-7

Consideration received	300,000
Less: Tax WDV (W)	(256,687)
	43,313

(Working) Calculation of WDV at the time of disposal

WDV				300,000
Cost			(300,000 x 15% x 50%)	(22,500)
Less:	Depreciation	(30.6.2021)		277,500
WDV		(30.6.2021)	(277,500 x 15% x 50%)	(20,813)
Less:	Depreciation			256,687
WDV		(at disposal)		

Question-8
Mr. A disposed off its factory building for Rs. 650,000. It was purchased for Rs. 700,000 and its WDV on disposal was Rs. 277,000.
Compute tax gain/ (loss) on disposal?

Answer-8

Consideration received	650,000
Less: Tax WDV	(277,000)
Gain on disposal	373,000

Question-9
Mr. A disposed off its factory building for Rs. 650,000. It was purchased for Rs. 400,000 and its tax WDV on disposal was Rs. 277,000.
Compute tax gain/ (loss) on disposal?

Answer-9

Consideration received		650,000
Less: Tax WDV		
Cost	650,000	
Accumulated depreciation (400,000- 277,000)	(123,000)	(527,000)
Gain on disposal		123,000

Question-10
Mr. A disposed off a car used in his business for Rs. 1,300,000. It was purchased for Rs. 1,450,000 and its WDV on disposal was Rs, 1,200,000.
Compute tax gain/(loss) or disposal?

Answer-10

Consideration received	1,300,000
Less: Tax WDV	(1,200,000)
Gain on disposal	100,000

Question-11
Mr. A disposed off a car used in his business for Rs. 1,300,000. It was purchased for Rs. 2,650,000 and its WDV on disposal was Rs. 1,200,000.
Compute tax gain/ (loss) on disposal?

Answer-11

Consideration received	(1,300,000/2,650,000) x 2,500,000	1,226,415
Less: Tax WDV		(1,200,000)
Gain on disposal		26,415

Question-12
Mr. A disposed off furniture used in his business on March 17, 2023 for Rs. 800,000. It was purchased for Rs. 700,000 on May 20, 2021. Since its purchase it has been used 80% in business. Compute tax gain/ (loss) on disposal?

Answer-12

Consideration received		800,000
Less: Tax written down value	509,097	
Add: Deductions not allowed		
TY2021	10,500	
TY2022	19,425	
TY2023	8,256	(547,278)
Gain on disposal		252,722

Depreciation

		Depreciation Calculation @15%	Normal Depreciation Allowed Dep * 80%	Depreciation not allowed Dep * 20%
Cost		700,000		
Depreciation	(700,000 x 15% x 50%)	(52,500)	42,000	10,500
WDV as on 30.6.21		647,500		
Depreciation	(647,500 x 15%)	(97,125)	77,700	19,425
WDV as on 30.6.22		550,375		
Depreciation	(550,375 x 15% x 50%)	(41,278)	33,022	8,256
WDV as on disposal		509,097		

Question-13

Mr. A disposed off furniture used in his business on March 17, 2023 for Rs. 800,000. It was purchased for Rs. 700,000 on May 20, 2021. In TY 2021 it was used 80% in business and in TY 2022 it was used 100% in business and in TY 2023 it was used 40% in business. Compute gain/ (loss) on disposal?

Answer-13

Consideration received		800,000
Less: Tax written down value	509,097	
Add: Deductions not allowed		
TY2021	10,500	
TY2022	-	
TY2023	24,767	(544,364)
Gain on disposal		255,636

	Depreciation Calculation	Normal Depreciation Allowed	Depreciation not allowed
Cost	700,000		
Depreciation (700,000 x 15% x 50%)	(52,500)	42,000	10,500
WDV as on 30.6.21	647,500		
Depreciation (647,500 x 15%)	(97,125)	97,125	-
WDV as on 30.6.22	550,375		
Depreciation (550,375 x 15% x 50%)	(41,278)	16,511	24,767
WDV as on disposal	509,097		

Question-14

Mr. A exported a computer which was previously used as fixed asset in his business to Bangladesh against consideration of Rs. 300,000. The cost of asset was Rs. 200,000 and its WDV at the time of disposal was Rs. 20,000.

Compute tax gain / (loss) on disposal?

Answer-14

Consideration received	200,000
Less: Tax WDV	(20,000)
Gain on disposal	180,000

Intangibles [Sec. 24]

1. Method to be used is straight line.
2. Amortization based on number of days used will be charged in the year of purchase while no amortization will be charged in the year of disposal. (There is no concept of applying 50% factor in year of purchase and sale.)
3. Residual value given in the question will be ignored.
4. There is no concept of initial allowance in respect of intangibles.

Following are the basis of amortisation of intangibles:	
Life	**Amortisation period**
Where life of an intangible is ascertainable	It will be amortised over useful life in whole numbers.
Where life of an intangible is not ascertainable	Useful life will be assumed as 25 years.

Definitions

(11) In this section, -
"cost" in relation to an intangible, means any expenditure incurred in acquiring or creating the intangible, including any expenditure incurred in improving or renewing the intangible; and
"intangible" means any patent, invention, design or model, secret formula or process, copyright, trademark scientific or technical knowledge, computer software, motion picture film, export quotas, franchise, license, intellectual property, contractual rights and any expenditure that provides an advantage or benefit for a period of more than one year (other than expenditure incurred to acquire a depreciable asset or unimproved land) but shall not include self-generated goodwill or any adjustment due to any accounting treatment.

Intangibles eligible for amortisation

(1) An amortization deduction shall be allowed on intangibles–
 (a) that are wholly or partly used by the person in deriving chargeable income from business; and
 (b) that have a normal useful life exceeding 1 year.

(2) No deduction shall be allowed if full cost of intangible asset is allowed as deduction in the year of purchase.

(7) The total deductions allowed during ownership of intangible shall not exceed the cost of the intangible.

Method for computation of amortisation charge

(3) The amortization deduction for a tax year shall be computed as follows:–

A/B

where–
A is the cost of the intangible; and
B is the normal useful life of the intangible in whole years.

(10) An intangible that is available for use on a day (including a non-working day) is assumed as used on that day.

(4) Where the useful life of an intangible is not ascertainable, the useful life will be taken as 25 years;

(5) Where an intangible is used partly in deriving income from business and partly for another use, the amortization will be allowed on proportionate basis.

(6) If an intangible is not used for whole of the tax year, the deduction shall be computed as follows:–

A x B/C

where –
A is the amount of amortization;
B is the number of days in the tax year the intangible is used in deriving income from business; and
C is the number of days in the tax year.

Tax Gain/(loss) on disposal

(8) On disposal of an intangible, no amortisation shall be allowed in year of disposal and –
 (a) if the consideration exceeds the WDV, the excess shall be chargeable under the head "Income from Business"
 (b) if the consideration is less than the WDV, the difference is deduction under the head "Income from Business".

(9) (a) The WDV at the time of disposal shall be calculated as follows–

Scenario	Written down value equals to
Where asset is wholly used for business	the cost of the intangible less total amortisation deductions allowed to the person on intangible or,
where the intangible is not wholly used to derive income chargeable to tax,	the cost of the intangible less amortisation that would be allowed if the intangible was wholly used

 (b) the consideration received on disposal shall be determined under section 77.

Example-1
Mr. Anjum has purchased an intangible costing Rs. 600,000 on 1.7.2012. Its useful life is 12 years. Calculate amortization expense for first 3 years.

Answer-1

Amortization – TY 2013	(600,000 / 12)	50,000
Amortization – TY 2014	(600,000 / 12)	50,000
Amortization – TY 2015	(600,000 / 12)	50,000

Example-2
Mr. Akram has purchased a computer software costing Rs. 300,000 on 1.07.2012. Its residual value is Rs. 10,000. Its life is 30 years. Calculate amortization expense for first 3 years.

Answer-2

Amortization – 2013	(300,000 / 30)	10,000
Amortization – 2014	(300,000 / 30)	10,000
Amortization – 2015	(300,000 / 30)	10,000

Example-3
Mr. Wasim has purchased a computer software costing Rs. 1,000,000 on 1.07.2012. Its residual value is Rs. 10,000. Its useful life is not ascertainable. Calculate amortization expense for first 3 years.

Answer-3

Amortization – 2013	(1,000,000 / 25)	40,000
Amortization – 2014	(1,000,000 / 25)	40,000
Amortization – 2015	(1,000,000 / 25)	40,000

Example-4
Mr. Ali has purchased a computer software costing Rs. 300,000 on 1 March 2013.Its residual value is Rs. 10,000. Its life is 6 years. Calculate amortization expense for first 3 years.

Answer-4

Amortization – 2013	(300,000 / 6) x 122/365	16,712
Amortization – 2014	(300,000 / 6)	50,000
Amortization – 2015	(300,000 / 6)	50,000

Example-5
Continuing from example-4 Mr. Ali disposed off the software on 1 September 2015 for Rs. 170,000. Calculate gain/(loss) for TY 2016?

Answer-5

Consideration received			170,000
Less:	WDV	(300,000 – 16,712 – 50,000 – 50,000)	(183,288)
Loss			(13,288)

Example-6
Mr. 7-UP has purchased a software costing Rs. 300,000 on 1 March 2013. Its life is 6 years. It is used 60% in business. Calculate amortization expense for first 3 years?

Answer-6

Amortization – 2013	(300,000 / 6)	x 60 % x 122/365	10,027
Amortization – 2014	(300,000 / 6)	x 60%	30,000
Amortization – 2015	(300,000 / 6)	x 60%	30,000

Example-7
Continuing from Q. 6 on 1 September 2015 the software is sold for Rs. 170,000.
Calculate gain/(loss)?

Answer-7

Consideration			170,000
Less:	WDV	(300,000 – 16,712 – 50,000 – 50,000)	(183,288)
Loss			(13,288)

Working for amortization expense assuming solely used in business

Amortization – 2013	(300,000 / 6) x 122/365	16,712
Amortization – 2014	(300,000 / 6)	50,000
Amortization – 2015	(300,000 / 6)	50,000

Pre-commencement expenditure [Sec. 25]

(5) **"Pre-commencement expenditure"** is an expenditure incurred before the commencement of a business wholly and exclusively for business, including:

- feasibility studies,
- construction of prototypes, and
- trial production activities,

It shall not include any expenditure for land, or for asset which is depreciated or amortised.

(1) A person shall be allowed a deduction for pre-commencement expenditure.
(2) It shall be amortized on a straight- line basis at the rate of 20%.
(3) The total deductions allowed in the current and all previous tax years shall not exceed the expense.
(4) No amortization deduction shall be allowed where full expenditure is allowed as deduction in the year of incurrence.

Scientific research expenditure [Sec. 26]

(1) A deduction will be allowed for scientific research expenditure in Pakistan wholly and exclusively for business.
(2) In this section –

"scientific research" means any activity in Pakistan in the fields of natural/applied science for the development of human knowledge;

"scientific research expenditure" means expenditure on scientific research in Pakistan for development of business, including any contribution to a scientific research institution, other than expenditure incurred:

(a) in the acquisition of any depreciable asset or intangible;
(b) in the acquisition of immovable property; or
(c) for ascertaining the existence, location or quality of a natural deposit; and

"scientific research institution" means institution certified by Board for conducting research in Pakistan.

Employee training and facilities [Sec. 27]

A person shall be allowed a deduction for expenditure (other than capital expenditure) incurred for–

(a) educational institution or hospital in Pakistan established for benefit of employees and their dependents;
(b) institute in Pakistan for training of industrial workers recognized by Federal, Provincial, Local Government;
(c) the training of a citizen of Pakistan, in connection with a scheme approved by the Board.

Bad debts [Sec. 29]

(1) A person shall be allowed a deduction for a bad debt in a tax year if following conditions are satisfied:

(a) the debt was –
  (i) previously included in the person's income from business; or
  (ii) for a money lent by a financial institution in deriving income from business;
(b) the debt or part of the debt is written off in the accounts of the person in the tax year; and
(c) there are reasonable grounds for believing that the debt is irrecoverable.

> EXPLANATION: "Included in Person's income" means credit sale.
> Note: Provision for doubtful debt is not a tax allowable expense.

Following are the 3 examples which explain that bad debt will be allowed as deduction or not:

Example 1			Example 2			Example 3		
Metro Books			Metro Books			Books of Bank		
Metro cash n carry sold goods to a customer for Rs. 10 on credit and later on the debt was proved to be bad.			Metro cash n carry provided loan of Rs. 6 to one of its employee and later on the employee run away with the money.			MCB provided loan to one of its customer of Rs.6 and later on the debt was proved to be bad.		
Debtor	10		Loan Receivable	6		Loan Receivable	6	
Sale		10	Cash		6	Cash		6
Bad Debt	10		Bad Debt	6		Bad Debt	6	
Debtor		10	Loan rec.		6	Loan rec.		6
Conclusion: As the debt was previously included in the Metro's income from business so bad debt **shall be allowed** as deduction to Metro.			Conclusion: As the debt was not previously included in the Metro's income from business so bad debt **shall not be allowed** as deduction to Metro.			Conclusion: Although the debt is not previously included in income from business but still **allowed as deduction** because the loan provider is a financial institution.		

(2) The bad debt deduction for a tax year shall not exceed the debt written off in the accounts of the person.

(3) Where bad debt deduction has been allowed in a tax year and in a subsequent tax year the person recovers any amount, the following rules shall apply:–

(a) Where the bad debt recovery is greater than the difference between:
- the whole of bad debt and
- the amount previously allowed as a deduction,

the excess shall be included under "Income from Business" in the tax year in which it is received; or

(b) where the bad debt recovery is less than the difference between:
- the whole of bad debt and
- the amount previously allowed as a deduction,

the shortfall shall be allowed as deduction under "Income from Business" for the tax year in which it was received.

Examples of partial recovery

Example-1

A manufacturer has disclosed accounting profit of Rs. 600,000 for TY 2011. This is arrived at by deducting bad debt of Rs. 200,000. However commissioner allowed only Rs. 180,000 as bad.

Required:

Calculate taxable income for TY 2011?

Answer-1

Accounting profit		600,000
Add:	Accounting bad debts	200,000
Less:	Tax bad debts	(180,000)
Total taxable income		620,000

Example-2

Continuing from Q.1 in TY 2012, he disclosed Rs. 700,000 as accounting profit which includes Rs. 25,000 for bad debts recovery relating to previous year debt.

Required:

Calculate taxable income TY 2012.

Answer-2

Accounting profit			700,000
Less: Accounting bad debt recovery			(25,000)
Add: Tax bad debt recovery (W-1)			5,000
Taxable income			680,000
(W-1)			
Amount received			25,000
Less: Actual amount of bad debt	200,000		
Less: Previously allowed as deduction	(180,000)		(20,000)
			5,000

Example-3

Continuing from Q.1 assume in TY 2012, he disclosed Rs. 700,000 as accounting profit which includes Rs. 13,000 for bad debts recovery relating to previous year debt.

Required:

Calculate taxable income TY 2012.

Answer-3

Accounting profit		700,000
Less: Accounting bad debt recovery		(13,000)
Add: Tax bad debt (W-1)		(7,000)
Taxable income		680,000
(W-1)		
Amount received		13,000
Less: Actual amount of bad debt	200,000	
Less: Previously allowed as deduction	(180,000)	(20,000)
		(7,000)

TAX ACCOUNTING

Method of accounting [Sec. 32]

(1) A person's chargeable income shall be computed as per method of accounting regularly employed.

(2) A company shall record "Income from Business" on an accrual basis, while other persons may record on a cash or accrual basis.

(3) The Board may prescribe that any class of persons shall account for income under the head "Income from Business" on a cash or accrual basis.

(4) A person may apply for a change in the person's method of accounting and the Commissioner may approve application if change is necessary to reflect the person's income under "Income from Business".

(5) If a person's method of accounting has changed, the person shall adjust income, deduction and credit, so that:
- no item is omitted and
- no item is taken into account more than once.

Cash-basis accounting [Sec. 33]

A person accounting for income chargeable under "Income from Business" on a cash basis shall:
- derive income when it is received and
- incur expenditure when it is paid

Accrual-basis accounting [Sec. 34]

(1) A person accounting for income chargeable under the head "Income from Business" on an accrual basis shall:
- derive income when it is due and
- incur expenditure when it is payable.

(2) An amount is due when the person becomes entitled to receive it even if:
- the time for discharge of the entitlement is postponed or
- the amount is payable by installments.

(3) An amount is payable by a person when:
- the events show that liability have occurred and
- the amount of liability can be determined with reasonable accuracy.

(5) Where a deduction is allowed for any expenditure in "Income from Business" and the person has not paid the liability within 3 years of the end of the tax year in which the deduction was allowed, the unpaid liability shall be chargeable under the head "Income from Business" in the first tax year following the end of the 3 years.

Mr. Asif has incurred repair expense of Rs. 10,000 in TY 2009 and it was allowed as deduction by tax authorities in the same year. It was not subsequently paid, therefore it will be treated as income in Ty 2013.

(6) Where an unpaid liability is added in income (as above) and the person subsequently pays the liability, a deduction will be allowed in the year of payment.

(5A) If a deduction is allowed for trading liability and person derives any benefit against it, the benefit shall be chargeable under "Income from Business" in year of receipt.

Stock-in-trade [Sec. 35]

(1) For calculating "Income from Business" for a tax year, the cost of stock-in-trade disposed is calculated as follows:–

$$(A + B) - C$$

where –
A is the opening value of the person's stock;
B is cost of stock-in-trade acquired in the year; and
C is the closing value of stock.

(2), (3) The opening value of stock-in-trade for a tax year shall be –
(a) the closing value of the person's stock-in-trade at the end of the previous year; or
(b) Where the person commenced the business in the year, the fair market value of stock acquired prior to the commencement of the business. The FMV shall be determined at the time the stock is put in the business.

(4) The closing value of stock shall be the lower of cost or net realizable value at the end of the year.

(5) A person using cash basis accounting may compute cost of stock on the prime-cost or absorption-cost method. A person using accrual basis shall compute cost of stock on the absorption-cost method.

(6) Where items of stock are not readily identifiable, a person may use first-in-first-out method or the average-cost method. Once chosen, a stock valuation method may be changed with permission of the Commissioner and as per the conditions imposed by him.

(7) In this section, -
"stock-in-trade" means anything:
- produced, manufactured, purchased
- acquired for manufacture, sale or exchange or
- any materials to be consumed in the production process.

However shares will not be considered as stock-in-trade;
"direct material costs" means material cost that become an integral part of stock;
"direct labour costs" means labour cost directly related to the manufacture of stock;
"variable factory overhead costs" means overhead which vary directly with changes in volume of stock.
"factory overhead costs" means total manufacturing cost, other than direct labour and material;
"first-in-first-out method" is an accounting principle in which stock is valued on the assumption that it is sold in the order of acquisition;
"average-cost method" is an accounting principle in which stock is valued on a weighted average cost of units;
"prime-cost method" is a method in which cost of stock is the sum of direct material, direct labour, and variable factory overhead;
"absorption-cost method" means the generally accepted accounting principle under which the cost of stock is the sum of direct material, direct labour, and factory overhead;

Profit on debt, financial costs and lease payments [Sec. 28]

(1) A deduction shall be allowed for a tax year for:

(Say) Books of Dawlance

(b) lease rental paid by a person to a bank, leasing company for asset used in business, For deduction of lease rentals the cost of passenger transport vehicle not plying for hire shall not exceed Rs. 2,500,000;

> Note: It means that if we acquire a car on lease and the total leases rentals over the lease term exceeds Rs. 2,500,000, we will deduct only Rs. 2,500,000

(a) any profit on debt (interest on loan) paid by a person, if loan is used in business;

(c) any amount paid to a modaraba or a participation term certificate holder for funds borrowed;

(i) any amount paid by a person to a musharika certificate holder; or

(h) any amount paid by a person to a bank under a scheme of musharika;

Books of bank

(d) any amount paid by a bank to a person maintaining a profit or loss sharing account or a deposit account.

Books of lessor

(j) the financial cost of the securitization of receivables being the difference between the:
- amount receivable by the Originator (lessor) and
- the amount received from SPV (Special Purpose Vehicle).

Books of HBFC/NDLC and SME

(e),(f),(g) any interest paid by the House Building Finance Corporation/ National Development Leasing Corporation Limited/ Small and Medium Enterprises Bank to the SBP on loan provided by SBP.

Discussion on adjustment (b) above

Lease

It is an arrangement in which lessee pays to lessor (bank) normally a series of installments (lease rentals) to obtain a right to use an underlying asset for a specific period of time. Following is the view point of accountants and tax authorities regarding leased asset:

Accounting view	**Tax view**
As per accountants, in case of lease the lessee has purchased the asset and he is making payment for the asset in installments. Accountants record two expenses in case of leased asset: 1. Depreciation on leased asset 2. Interest paid (finance charges) which is included in lease rental.	As per tax authorities lessee is only paying rent for the asset and he has not purchased the asset. Tax authorities only allow "lease rental" paid to bank as an expense.

Conclusion: "Depreciation on leased asset" and "interest expense" are not allowed as deduction and "lease rental" is allowed as an expense.

Further sometimes lessee pays to lessor security deposit at commencement of lease. It is not allowed as deduction.

If in the numerical we start from accounting profit following would be the presentation of leased asset:

Net profit		xx
Add:	Accounting depreciation	xx
	Interest expense	xx
Less:	Lease rental	(xx)
Total income		xx
Less:	Zakat	(xx)
Taxable income		xx

Disposal and acquisition of assets [Sec. 75]

Disposal

(1) An asset will be considered as disposed off when its ownership comes to an end, including when it is:
   (a) sold, exchanged, transferred or distributed; or
   (b) cancelled, destroyed, lost, expired or surrendered.

(2) The transmission of an asset by succession or will shall be considered as disposal at the time of transmission.

(3) The application of a business asset to personal use will be considered as disposal when asset is put to personal use.

(3A) Where a business asset is discarded or ceases to be used, it will be considered that it is disposed off.

(4) A disposal shall include the disposal of a part of an asset.

Acquisition

(5) The time of acquisition of an asset is the time when a person begins to own it, including the time for grant of right.

(6) The application of a personal asset to business use shall be considered as an acquisition when the asset is put to business use.

Definition

(7) In this section, -
"business asset" means an asset held wholly or partly for use in a business, including stock-in-trade and a depreciable asset; and
"personal asset" means an asset held wholly for personal use.

Cost [Sec. 76]

(1) This section shall establish the cost of an asset.

(2) The cost of purchased asset shall be sum of:
   (a) The total amount given for the asset, including the fair market value of consideration in kind determined at the time the asset is acquired;
   (b) any incidental expenditure paid in acquiring and disposing of the asset; and
   (c) expenditure paid to alter or improve the asset,

   but shall not include any expenditure (under clauses (b) and (c)) which is fully allowed as a deduction.

(3) If a personal asset is put to business use its cost will be the fair market value on the date it is put to business use.

(4) The cost of produced or constructed asset shall be the total costs incurred in producing or constructing the asset plus any incidental expenditure and expenditure paid to alter or improve the asset.

(5) If an asset is purchased with a loan from foreign currency, then any increase/decrease in the liability (before repayment) due to currency fluctuation will be added/deducted in the cost of the asset.
Explanation: For the calculation of depreciation, currency fluctuation will be accounted for in year of occurrence.

Example

1 May: $200,000 loan received; 1$ = Rs. 140
30 June: $30,000 loan repaid; 1$ = Rs. 142

Answer

Inflow +140
Outflow -142
-2 x 30,000 = Rs. 60,000

Example

Mr. Ali is constructing an office building. For this following expenditures are incurred:

Labour	200,000
Bricks and cement	900,000
Payment to Engineer	100,000

For the construction of office he took loan in foreign currency of $13,000 (1$=Rs.100) On 1st July 2015.
First payment of loan is due on 30.06.16 in $1,000
At the date of payment (1$=Rs.102)

Required: Calculate cost of house and give justification to support your answer.

Answer

Labour	200,000
Bricks and cement	900,000
Engineer	100,000
Effect of Currency fluctuation (102-100) × 1,000	2,000
Total cost	1,202,000

The cost of constructed asset shall be total cost incurred in constructing asset plus any incidental expenditure if the asset is purchased with a loan from foreign currency then any increase in liability due to currency fluctuation will be added in cost of asset.

(6) In determining whether the liability of a person has increased or decreased (for the purposes of sub-section (5)), hedging agreement will be considered.

(10) The cost of an asset does not include the amount of any grant, subsidy, rebate, commission or other assistance (other than a loan repayable with or without profit) received in respect of the acquisition of the asset. However if grant, subsidy, rebate, commission or assistance is chargeable to tax then it will be added in the cost.

The Government has given an incentive to a shoe manufacturing company that if it imports a special plant, Government will give grant equal to 20% of its cost and the grant is not chargeable to tax. Consequently the company imported the plant at Rs. 5 million. When plant was received in factory the grant was provided in cash. In this case plant's cost is Rs. 4 million (5 million less 20%) only.

Example

Mr. Ali is engaged in construction business, he imported machinery from Korea. Following are details

- The cost paid in Korea is 100,000,000.
- Import charges of Rs.400,000 are paid.
- Machine arrived at Karachi Port at 1st July 2020.
- Freight charges paid are Rs.200,000.
- The government gives 10% grant on cost. The grant is exempt tax.
- Paid Rs.500,000 as fine for not picking the machine on time from sea port.
- Paid 100,000 for installation of machinery and gave a party to staff and incurred 20,000 on it.
- The machinery installed on 1st January 2021 but it is still not available for use. It became available for use on 1st March 2021.

Required: Calculate cost and tax WDV of machine as on June 30, 2021.

Answer

Cost	[100,000,000 - 10% × 100,000,000]	90,000,000
Import charges		400,000
Freight charges		200,000
Installation Charges		100,000
Cost		90,700,000
Less: Initial allowance	(90,700,000×25%)	(22,675,000)
		68,025,000
Less: Tax depreciation	(68,025,000 × 15% x 50%)	(5,101,875)
Tax WDV		62,923,125

The cost of purchased assets shall include the amount paid to acquire asset but it shall not include any grant that is not chargeable to tax and the cost of purchased asset include any incidental expenditure paid in acquiring the asset.

(7) Where a part of an asset is disposed, the cost shall be apportioned between the part retained and the part disposed of in accordance with their fair market values determined at the time asset is purchased.

An asset was purchased in TY 2009 for Rs. 40,000. The Asset comprised of two components M and H. The FMV of M at the time of purchase was Rs. 35,000 and of H was Rs. 10,000. The component M of asset is disposed off in TY 2011. Calculate its cost at the time of disposal.

Answer

Cost of M at the time of disposal = 40,000/(35,000+10,000) x 35,000 = 31,111

(8) Where the acquisition of an asset is the derivation of an amount chargeable to tax, the cost of the asset shall be equal to chargeable amount plus any amount paid for the asset.

> Example
> Mr. Ifan is in the business of preparing tax returns. During the year he prepared the tax return for a person selling computers in Hafeez Centre for which he will charge him Rs. 8,000. At the time of settlement it was agreed that shopkeeper will not pay any money rather he will give a computer as consideration for Ifan's service. No amount is paid by Ifan for acquiring the computer.
> The cost of computer in this case is amount chargeable to tax in the hands of Ifan which is Rs. 8,000.

(9) Where the acquisition of an asset is the derivation of an amount exempt from tax, the cost of the asset shall be equal to exempt amount plus any amount paid for the asset.

Asset acquired under lease on or before maturity of lease agreement

If an asset under lease is acquired by lessee on or before maturity of lease agreement than its cost will be residual value or bargain purchase option.

Motor vehicle	Rs.
Cost at the time acquired	1,000,000
Bargain purchase price:	
Before payment of 7th installment	1,000,000
After payment of 7th but before payment of 11th Installment	750,000
After payment of 11th but before payment of 17th Installment	500,000
After payment of 17th but before payment of 22th Installment	250,000
Residual value on maturity of lease	70,000
Monthly lease rental	60,000
No. of installments	22

The asset is acquired after 15th installment.

Answer

Cost of motor vehicle for the purpose of depreciation deduction	500,000

Exam Note for students:

1. If accounting Written down value or Fair Value are given in question, then ignore them and search for Residual Value or Bargain Purchase Price.
2. If an asset is purchased at or before expiry of lease, then depreciation will not be apportioned to 50% in the year of purchase because it was previously used in person's business. Further initial allowance will also not be calculated in this case.

PRACTICE QUESTIONS (SECTION 76)

Question-1

An entity purchased an asset costing Rs. 70,000. Subsidy received from Government in this regard is Rs. 15,000. Calculate the cost of asset assuming subsidy is exempt.

Answer-1

Cost - net	55,000

Question-2

An entity purchased an asset costing Rs. 70,000. Subsidy received from Government in this regard is Rs. 15,000. Calculate the cost of asset assuming subsidy is taxable.

Answer-2

Cost - net	55,000
Add: Subsidy (Taxable)	15,000
	70,000

Question-3
An entity purchased an asset costing Rs. 40,000. Loan received from Government for buying this asset is Rs. 12,000. Calculate the cost of asset.

Answer-3

Cost	40,000

Question-4
Burewala Express Limited (BEL) is in the business of manufacturing and sale of component parts for automobile assembly industry. On 1 January 2022, BEL took a loan of US$ 700 from GHI Bank, USA, which was utilized for purchasing the plant. The loan is repayable in 7 equal installments in US Dollars. The rate of exchange on 1 January 2022 was US$ 1 equal to Rs.98. Other information:
The Project was completed in June 2023, but was only commissioned for use on 31 July 2023. The total amount spent by BEL on the plant was Rs. 200,000
On 1 July 2023, the Government of Pakistan (GOP) voluntarily paid BELRs.10,000 as a subsidy in respect of the plant installed in the Project.
The first installment of US$ 100 towards repayment of the US Dollar loan was paid to GHI Bank on 30 June 2024. The rupee equivalent of US$100 at the then rate of exchange was Rs.10,000 (US$ 1= Rs.100).

Required: Calculate the initial allowance, depreciation and written down value of the plant on 30 June 2024 for preparing the tax return for tax year 2024.

Answer-4
Note: As the question is silent so we will assume that subsidy is exempt from tax.

		Rs.
Net Cost (Net of subsidy)		190,000
~~Exempt subsidy~~		-
Currency loss/(gain)		200
Cost as per S.76		190,200
Less: Initial allowance	(190,200 x 25%) (30.6.24)	(47,550)
		142,650
Less: Depreciation	(142,650 x 15% x 50%) (30.6.24)	(10,699)
Tax W.D.V		131,951

Working Currency gain/loss

Rate at time of inflow		98
Rate at time of outflow		(100)
Loss		(2)
Loss on Repayment	[100$ x - 2]	(200)

Question-5
An entity decided to finance the cost of purchasing a plant with a loan in foreign currency. It obtained loan amounting to US$ 2,000 on 1 May when exchange rate was (US$ 1= Rs.140). On 30 June first repayment of US$ 300 was made when exchange rate was (US$ 1= Rs.137). Asset is purchased for Rs. 500,000. Subsidy received from Government in this regard is Rs. 20,000 which is taxable. Calculate the cost of asset.

Answer-5

Net Cost (Net of subsidy)	480,000
Add: Subsidy (Taxable)	20,000
Currency loss/(gain)	(900)
Cost as per S.76	499,100

Working Currency gain/loss

Rate at time of inflow		140
Rate at time of outflow		(137)
Gain		3
Gain on repayment	(300$ x 3)	900

Question-6

You purchased an aero plane for Rs. 200 million on January 1, 2015. On January 1, 2019 seats were sold. The fair value of the seats and other aero plane on January 1, 2015 was Rs. 20 and Rs. 190 million respectively.
Calculate the cost of seats?

Answer-6

Cost of seat	$200 \times \frac{20}{(190+20)}$	19.05

Consideration received [Sec. 77]

This section deals with consideration received on disposal of capital asset, disposal of securities, disposal of immoveable property and disposal of business assets (tangibles, intangibles).

(1) The consideration received on disposal of an asset shall be:

- the total amount received or
- its fair market value,

whichever is the higher, including the fair market value of any consideration received in kind determined at the time of disposal.

(2) Where an asset is lost or destroyed, the consideration received shall include any compensation, indemnity or damages received by the person under:

(a) an insurance policy, indemnity or other agreement;
(b) a settlement; or
(c) a judicial decision.

Example

Mr. Danish has a car. Tax WDV of that car is 250,000 at 1.7.15. There was a severe accident on 1.1.16 in which car was damaged. He sold that car on 1.2.16 for Rs.100,000 and from insurance company he got an additional amount of Rs.600,000. Tax depreciation rate for car is 15%.
Required: Calculate profit chargeable to tax.

Answer

Consideration	[100,000 + 600,000]	700,000
Less: Tax WDV		(250,000)
		450,000

The consideration received on the disposal of asset include the compensation received insurance policy and also from scrap sale.
No depreciation will be charged on asset in the year of disposal.

(3) If:

- a business asset is put to personal use or
- an asset is discarded or ceased to be used in business

its consideration received shall be the fair market value on the date the event took place.

Example

Mr. Ali runs an automobile business. He has a car for business use of FV 800,000, he put that car for personal use. What is the consideration of that car?

Answer

If a business asset put into personal use its consideration received shall be the FMV on the date the event took place i.e transfer of car from business to personal use.

(4) The actual consideration received by a bank or leasing company (approved by the Commissioner) for an asset leased by the company to another person shall be the residual value received on maturity of the lease agreement. The condition is that the residual value plus the amount realized during the term of the lease of the asset is not less than the original cost of the asset.

(5) Where two or more assets are disposed of in a single transaction and actual consideration for each asset is not specified, the total consideration received shall be apportioned between assets disposed of in proportion to their respective fair market values at the time of the transaction.

Example

Shaoor is the sole proprietor of Shaoor Enterprises (SE). On 31 January 20X8 SE sold a factory building including land for Rs. 10 million. At the time of disposal, the fair market values of the land and building were Rs. 3 million and Rs. 5 million respectively.

The land and building were acquired on 1 July 20X6 at a cost of Rs. 2 million and Rs. 6 million respectively. The tax WDV of the building at time of disposal was Rs. 5.4 million.

Compute taxable income under correct head for TY 20X8? **(05)**

(ICAP-March 2018)

Answer

Income from business		Rupees (Millions)
Building		
Consideration (N-1) [(10 / 8) x 5]		6.25
Less: Tax WDV		
Cost (N-2)	6.25	
Accumulated Depreciation (6 – 5.4)	(0.6)	(5.65)
Income from Business		0.6

Gain on disposal of immoveable property (Taxable as separate block of income)	Rupees (Millions)
Land	
Consideration (N-1) [(10 / 8) x 3]	3.75
Less: Cost	(2)
Gain / Loss	1.75
Taxable gain (1.75 x ¾)	1.31

Note:

1. Where two or more assets are disposed of in a single transaction and actual consideration for each asset is not specified, the total consideration received shall be apportioned between assets disposed of in proportion to their respective fair market values at the time of the transaction. Therefore the consideration of Rs. 10 million will be apportioned as per the fair market values of land and building. [S. 77]
2. Where consideration received on the disposal of building exceeds its cost the consideration shall be treated as cost of the asset. [S.22]

Purchase of immoveable property in cash [Sec 75A]

If immovable property having fair market value (FBR value or DC rate whichever is applicable) greater than Rs. 5 million is purchased in cash, then it will have the following implications:

(i) Such amount shall not be treated as cost for computation of any gain on disposal

(ii) Such person shall pay a penalty of 5% of the fair market value (paid in cash).

Example

On 15 January 2021, Mr. A sold a house situated in Karachi for Rs. 15,000,000. He had purchased this house in July 2020 for Rs. 19,000,000 out of which Rs. 6,000,000 was paid in cash.

Answer

Cash exceeding Rs.5 million will not be considered as cost.

Therefore gain will be calculated as follows:

Consideration	= A	=	15,000,000
Cost	= B	=	13,000,000
Gain	= A – B	=	15,000,0000 – 13,000,000 = 2,000,000

Further Mr.A will also have to pay penalty of Rs. 6,000,000 x 5%= Rs. 300,000.

Exemption on Capital gain

(Clause 114AA Part 1 of 2nd Sch.)

Capital gain of resident individual from sale of **constructed residential property** shall be exempt if:

(i) residential property is used for personal accommodation by him or his family

(ii) the land area of the property does not exceed 500 square yards in case of a house and 4,000 square feet in case of a flat; and

(iii) exemption is not previously claimed by him

(Clause 114B Part 1 of 2nd Sch.)

Capital gain on sale of property is exempt for dependent of:

- Shaheed or
- a person who dies during service of PAFs or Federal or Provincial Government.

Speculation business [Sec. 19]

(1) Tax implications of speculation business

Where a person carries on a speculation business –

(a) it shall be treated as separate from any other business;

(b) income from speculation business shall be calculated separately from non-speculation business

(c) for apportionment of expenses speculation business will be considered as a separate head of income;

(d) profits of speculation business shall be included under the head "Income from Business"; and

(e) loss from speculation business shall not be adjusted against any other head.

(2) Definition and exceptions

In this section, "speculation business" means a business in which a contract for the purchase and sale of a commodity (including stocks and shares) is not settled by actual delivery of commodity.

Example

In August 2015, LT **signed a future contract** with ME **for the purchase** of 500 metric tons of maize at Rs. 15,000 per metric ton. The delivery was expected to be made in October 2015. ME also agreed to repurchase the entire lot at the price prevailing on the date of sale.

In October 2015 price of maize increased to Rs. 18,000 per metric ton and **LT sold** the entire lot to ME without taking delivery.

Calculate speculation gain/(loss) in the books of LT and ME?

Answer

Speculation gain/(loss) in books of LT

		Rs.
Gross Sale	(500 x 18,000)	9,000,000
Less: Cost	(500 x 15,000)	(7,500,000)
Speculation gain		1,500,000

Speculation gain/(loss) in books of ME

Speculation loss		(1,500,000)

However following will not be considered as speculative business:

(a) a contract for stock is made by a person during mercantile business to guard against loss through future price fluctuations for fulfilling the person's other contracts for the actual delivery of the goods;

(b) a contract for shares is made by a dealer/investor to guard against loss in the person's holding of shares through price fluctuations; or

(c) a contract made by a member of a forward market or stock exchange during any transaction of jobbing arbitrage to guard against loss which may arise in the ordinary course of business.

Minimum tax on the income of certain persons [Sec. 113]

(1) This section shall apply to:

- a resident company
- permanent establishment of a non-resident company
- an individual having turnover of 100 million rupees or above (in the tax year 2017 or in any subsequent tax year) and
- an association of persons having turnover of 100 million rupees or above (in the tax year 2017 or in any subsequent tax year)

This section shall apply where due to following reasons:

(a) loss for the year;
(b) the setting off of a loss of an earlier year;
(c) exemption from tax;
(d) the application of credits or rebates; or
(e) the claiming of allowances or deductions (including depreciation and amortization deductions)

no tax is payable or paid or tax payable or paid is less than 1.25% of turnover.

Explanation: The expression "tax payable or paid" does not include the tax on income which is considered as final discharge.

(2) Where this section applies:

(a) the turnover of the person shall be treated as the income of the person;
(b) the person shall pay income tax at 1.25% of person's turnover for the year; (Note: In some cases reduced rate is applicable)
(c) where tax paid at 1.25% of turnover exceeds the actual tax payable (calculated in normal way), the excess amount of tax paid shall be carried forward for adjustment against actual tax liability of the subsequent 5 tax years. The 5 years will start from the end of the year for which minimum tax is paid.

(3) **"turnover"** means,-

(a) the gross receipts from sale of goods, exclusive of:
   - Sales Tax and
   - Federal Excise duty or
   - any trade discounts shown on invoices or bills and

   The gross receipts from income falling under final taxation will not be taken into account.

(b) the gross fees for the rendering of services except receipts falling under final taxation;
(c) the gross receipts from the execution of contracts except receipts falling under final taxation; and
(d) the company's share of the above amounts received as share of profit from an AOP.

Explanation: Definition of turnover covers receipts from all business activities including receipts from sale of immoveable property (where such receipt is taxable under the head Income from Business).

Example-1 **Shopkeeper A** has provided following details:

Sales	95,500,000
Add: 17% Sales Tax	16,235,000
	111,735,000

S.113 does not apply

Example-2 **Shopkeeper B** has provided following details:

Sales	110,000,000
Less: Trade discount	(20,000,000)
	90,000,000

S.113 does not apply

Example-3 **Shopkeeper C** has provided following details:

Sales	90,500,000
Other income (dividend)	30,000,000
	120,500,000

S.113 does not apply

Example-4 **Rise College** has provided following details:

Revenue (Fees)	90,500,000
Other income (dividend)	30,000,000
	120,500,000

S.113 does not apply

Example-5 **Company** has provided following details:

Sales	3,000,000

This Company is also a partner in a partnership firm and has purchased 40% capital of partnership firm.
Sales of partnership firm is Rs. 1,000,000.
Calculate minimum tax?

Solution

Sales = 3,000,000 + (1,000,000 x 40%) = 3,400,000
Minimum tax = 3,400,000 x 1.25% = 42,500

Example-6
Following data relates to an AOP:

Year	Taxable income	Turnover
1	1,050,000	100,200,000
2	7,200,000	120,000,000
3	14,450,000	105,000,000

Calculate tax liability for each year?

Answer-6

Step-1

Year		Normal tax liability		1.25% of turnover
1	(10,000 + 10% x 450,000) (Table 1)	55,000	(100,200,000 x 1.25%)	1,252,500
2	(1,220,000 + 35% x 1,200,000)	1,640,000	(120,000,000 x 1.25%)	1,500,000
3	(1,220,000 + 35% x 8,450,000)	4,177,500	(105,000,000 x 1.25%)	1,312,500

Step-2

Year 1

Tax payable to Government (Higher of 55,000 or 1,252,500)	1,252,500

Tax of Rs. 1,197,500 will be carried forward

Year 2

Normal tax liability	1,640,000
Less: b/f minimum tax from Year 1 (bal.)	(140,000)
Tax payable to Government	1,500,000

Tax of Rs. 1,057,500 (1,197,500 – 140,000) will be carried forward

Year 3

Normal tax liability	4,177,500
Less: b/f minimum tax of Year 1	(1,057,500)
Tax payable to Government	3,120,000

ICAP PAST PAPER QUESTION

Question-1

Mr. XYZ, Deputy Managing Director of a public limited company attended a seminar on the subject of taxation. One of the speaker of the seminar in his speech said that it is necessary to determine

(a) tax status of the taxpayer to calculate the correct taxable income and tax liability

(b) he also said that expenditure incurred by a taxpayer may be of two types i.e. capital expenditure or revenue expenditure and

(c) he further said that the income tax Statute while taxing the income also provides relief from taxes as well under the provisions section 53 of the Income Tax ordinance, 2001.

The Deputy Managing Director has asked you as a Chief Accountant to explain to him in a write-up:

i) How does tax liability differ according to the tax status of the person? (6)

ii) Does the tax treatment differ in respect of capital and revenue expenditure? If so explain with examples. (4)

iii) How and to what exemptions from tax are provided under the provisions of section 53 of the Income Tax Ordinance, 2001. (4)

(Q.4 September1998)

Question-2

Mr. B is Managing Director (MD) of a XYZ public limited company. He is master of science in petroleum engineering with a little background of accounting and tax. He has been informed that the assessing officer may question the method of accounting of the XYZ public limited company in the context of determination of its total income for the purpose of charge of tax u/s 4. Whilst section 20 of the Income Tax Ordinance, 2001 specifies admissible deductions, section 21 of the Ordinance stipulate certain deductions which are not admissible under the law.

MD is not clear about certain things stated above and has asked you, as chief accountant to explain him the following in a write up:

(a) What types of income are chargeable under the head income from business u/s 18? (3)

(b) What are the six inadmissible deductions u/s 21 of the Ordinance for computing income from business? (3)

(c) How many *types* of method of accounting exist and under what circumstances taxation officer may not accept the taxpayer's method of accounting (3)

(Q.3 March 1999)

Question-3

What are the conditions in the law for admissibility of the following expenditure:

(i) lease payments (2)

(ii) interest (2)

(iii) salary and wages (2)

(iv) gratuity and provident fund (2)

(v) perquisites (2)

(Q.2 September 1999)

Question-4

Unpaid trading liability attracts income tax. Illustrate the provisions of income tax law covering this aspect. (6)

(Q.5 (b) March 2001)

Question-5

Whether or not the following are admissible under the Income Tax Ordinance, 2001:

a) Borrowing cost on loans obtained to purchase fixed assets (1)

b) Bonus shares issue expenses (1)

c) Preliminary expenses (1)

d) Bad debts (1)

(Q.3 March 2001)

Question-6

Discuss briefly the legal position with respect to the admissibility or otherwise of the following as business expenditure under the Income Tax Ordinance, 2001:

a) Amount paid as income tax (2)

b) Capital expenditure incurred on scientific research in Pakistan (2)

c) Share of profit paid to a bank under a scheme of musharika (2)
d) Interest paid by a firm to partner of the firm. (2)
e) Salary paid otherwise than through a crossed cheque etc. (2)

(Q.2 September 2001)

Question-7

Explain whether the following are admissible as business expenditure under the Income Tax Ordinance:

a) Repayment of principal amount of lease rentals of plant & machinery.
b) Sales tax paid on the purchase raw materials to be used in the production of exempt supply.
c) Dividend
d) Provision in respect of doubtful debts
e) Penalty levied under the Income Tax Ordinance, 2001 for failure to file statement. (10)

(Q.5 March 2002)

Question-8

Dreamland (Pvt.) Ltd. has requested you to advice as regards the important aspects of law for disallowance of expenses incurred in cash u/s 21.Please write an advisory letter in this regard explaining the law with suitable examples. (10)

(Q.5 September 2002)

Question-9

b) What method of accounting is required to be employed by a company deriving income from business? (2)

c) Briefly state the provisions relating to the change in the method of accounting of income from business. (3)

(Q.6 March 2003)

Question-10

a) Mercury & Co. has provided you the following data:

Fair value of leased asset	Rs.225,000
Interest rate	20.5%
Security Deposit paid	10% of fair value
Depreciation of leased asset	33% per annum
Term of lease	3 years
Yearly rental in arrears	Rs.96,890

You are required to compute amount available for deduction from the taxable income of Mercury & Co for each year. Please show proper working. (5)

(Q.4 (a) March 2003)

b) Sun & Moon has recently registered as partnership. They have incurred the following expenditure.

- Fee paid to consultants for preparation of registration deed Rs.50,000
- Preparation of feasibility report Rs. 100,000
- Purchase of office equipment Rs. 150,000
- Purchase of machinery Rs. 1,000,000
- Trial run cost Rs.200,000
- Installation cost Rs.50,000

You are required to explain the tax treatment by computing the amount allowable as deduction in accordance with the provisions of Income Tax Ordinance, 2001. (5)

(Q.4 (b) March 2003)

Question-11

Deleted

Question-12

a) Briefly explain when the expenditure is considered as incurred with reference to accrual basis of accounting defined in the Income Tax Ordinance, 2001. (3)

b) Please mention the costing method(s) and stock valuation method(s) to be applied by a person following accrual basis of accounting to account for income chargeable to tax under the head 'income from business' (3)

(Q.4 March 2004)

Question-13

a) List down the assets on which "Initial allowance" cannot be claimed? (4)

b) What are the prescribed rates of normal depreciation on the following assets as per the Third Schedule to the Income Tax Ordinance, 2001?

i. Factory building
ii. Residential quarter for labour
iii. Furniture
iv. Plant and machinery
v. Computer and hardware
vi. Technical books
vii. New ships
viii. Motor vehicle

(4)

(Q.3 September 2004)

Question-14

Describe the expenses which are allowable as a deduction on account of employees training and facilities? (4)

(Q.4 September 2004)

Question-15

Discuss the conditions required to be fulfilled for claiming a deduction on account of 'bad-debts'? (3)

(Q.5 September 2004)

Question-16

Describe any five types of expenses that are not allowed to be deducted under the head "income from business". (5)

(Q.3 March 2005)

Question-17

Describe the assets that are not eligible for the purpose of claiming initial depreciation allowance. (4)

(Q.4 (a) March 2005)

Question-18

a) Explain with reasons, as to whether or not the following expenses are admissible business expenditures:

(i) Penalty paid by a banking company on contravention of State Bank of Pakistan's regulations. (1)
(ii) Freight charges to forwarding agent amounting to Rs.60,000 paid in cash. (1)
(iii) Payment of salary to an employee from which tax was not deducted by the employer. However the employee paid the tax himself. (1)

b) What is the basis of stock-in-trade computation under the Income Tax Ordinance when the taxpayer follows the cash basis of accounting? (2)

c) Explain the provisions of section 29 with regard to the recovery of bad debts in subsequent years. (5)

(Q.3 March 2006)

Question-19

Define the following with reference to the Income Tax Ordinance, 2001:

- Depreciable asset (5)

(Q.2 (a) March 2006)

Question-20

A company may account for income chargeable to tax under the head 'income from business' on cash basis or on accrual basis.

Briefly discuss the rules relating to accrual of income and expenditure as explained in the Income Tax Ordinance, 2001. (4)

(Q.4 (a) September 2006)

Question-21

One of your clients, Japan and Company, a partnership having three partners, has sent you its latest financial statements for the year ended June 30, 2006. Following items are appearing under the head 'Other income':

(i) Accounting profit on disposal of fixed assets.
(ii) Reversal of provision for doubtful debts pertaining to the year ended June 30, 2004.
(iii) Dividend received from a listed company.

You are required to explain with reasons as to how the above items will be treated in the computation of taxable income. (3)

(Q.3 (b) September 2006)

Question-22

Discuss the provisions of the Income Tax Ordinance relating to the computation of opening and closing stock. (4)

(Q.2 (b) March 2007)

Question-23

A person who places an eligible depreciable asset into service in Pakistan for the first time in a tax year shall be allowed initial depreciation allowance. List down the assets which do not come under the purview of "eligible depreciable assets" for the purpose of initial allowance. (4)

(Q.6 (b) September 2007)

Question-24

Briefly discuss the allowability of the following against business income chargeable to tax:

(i) Payment of utility bills in cash amounting to Rs. 15,000.
(ii) Penalty of Rs.5,000 paid for late submission of quarterly statement under the Income Tax Ordinance, 2001.
(iii) Depreciation on leased assets amounting to Rs. 150,000. (5)

(Q.5 (b) September 2007)

Question-25

Discuss the taxability of the following under the Income Tax Ordinance, 2001:

(i) Bad debts (5)
(ii) Non-adjustable rent (4)
(iii) Speculation business (4)

(Q.4 (a) March 2008)

Question-26

Mr. Sajid is a sole proprietor involved in the distribution of fans manufactured by a Pakistani Company. He is in the process of computing his business income for tax year 2008 but is not clear about the tax treatment of the following items:

(i) Commission of Rs.20,000 was paid to his employee but no tax was deducted by him.
(ii) In his books of account, an expense of Rs.50,000 has been charged on account of various household expenses.
(iii) During the year, he purchased a car at a cost of Rs. 1,200,000 which has been used for personal as well as business purposes. Mr. Sajid wants to claim depreciation (including initial allowance) on the full amount of cost.
(iv) Computer software was purchased on January 1, 2008 at a cost of Rs.900,000. The software is likely to used for twelve years.
(v) His business assets worth Rs.500,000 were destroyed by the earthquake in October 2005. He claimed the loss in his return for tax year 2006 but an amount of Rs. 150,000 was disallowed by the taxation officer. In tax year 2008, the Government gave him a compensation of Rs.400,000 on this account.
(vi) Professional tax of Rs. 100,000 was paid to the Government of Punjab. Such tax is to be paid by every person who is engaged in the trading business in the territory of Punjab. He considers it inadmissible as it is a tax paid to a provincial government.

Explain the correct tax treatment of the above items under the Income Tax Ordinance, 2001. (12)

(Q.4 September 2008)

Question-27 Deleted

Question-28

(a) State the conditions which a tangible asset should meet to qualify as a depreciable asset. (4)
(b) During the tax year 2029, Ishaq Enterprise disposed off the following assets:
    (i) an immovable property was sold for Rs. 200 million. The cost of immovable property was Rs. 100 million. Till disposal, tax depreciation of Rs. 10 million had been allowed on the immovable property.
    (ii) a plant was exported to Nepal. The export proceeds amounted to Rs. 28 million. The cost and written down value at time of disposal of the plant was Rs. 25 million and Rs. 18 million respectively.

Required: Compute the tax gain or loss on disposal of each of the above assets. (4)

(Q.3 September 2009)

Question-29

You are the tax consultant of Ideal Associates who are engaged in the business of manufacture and sale of electronic goods for the last twenty years. The firm has requested for your opinion in respect of the following:

(i) Provision for bad debts.

(ii) Payment against a liability which was outstanding since 2006 and had been added back into the taxable income of the firm in 2009.

(iii) Initial depreciation allowance on a three-year old plant, which has been imported from China. The remaining useful life of the plant is 7 years.

Required:

Advise the management on the treatment of the above transactions, under the Income Tax Ordinance, 2001. (7)

(Q.4 (b) September 2010)

Question-30

Carrot Ltd (CL) is engaged in the manufacture, import and sale of electronic appliances for the past twenty years. When reviewing the company's tax provisions, you noticed the following amounts appearing in the tax calculation for the year ended June 30, 20X2.

(i) Expenditure of Rs. 450,000 on promotion of a product which is expected to generate revenue for twelve years.

(ii) Bad debt in respect of a staff loan, Rs. 25,000.

(iii) Initial allowance of Rs. 4,000,000 on a used equipment acquired locally from MSD Limited.

(iv) Financial charges amounting to Rs. 100,000 and depreciation amounting to Rs. 300,000 on a vehicle acquired on finance lease from Radish Leasing. Lease rentals paid during the year amounted to Rs. 400,000.

Required:

Under the provisions of Income Tax Ordinance, 2001 discuss the admissibility of the above amounts for tax purposes. (15)

(Q.3 March 2011)

Question-31

In the context of Income Tax Ordinance 2001,

(a) state the meaning of "Intangible". (4)

(b) discuss the rules relating to claiming of amortization deduction on intangibles. (7)

(Q.6 September 2012)

Question-32

(a) Describe the methods of accounting that may be adopted under the Income Tax Ordinance, 2001 by the following persons deriving income chargeable to tax under the head 'Income from Business'.

(i) A company (3)

(ii) Any person other than a company

(b) State the provisions of the Income Tax Ordinance, 2001 relating to the change in method of accounting for income chargeable to tax under the head 'Income from Business'. (3)

(Q.5 March 2013)

Question-33

In Income Tax Ordinance, 2001 the term "disposal" has a wider connotation than sale because it includes exchange, relinquishment, and extinguishment.

List the situations under which an asset owned by a person shall be treated to have been disposed of. (5)

(Q.4 September 2014)

Question-34

Under the provisions of the Income Tax Ordinance, 2001 what would be the cost of an asset for the purpose of depreciation deduction in each of the following circumstances?

(a) Mr. Aamir acquired a new machine partly in exchange for an old machine. He paid freight to bring the old machine to the seller's location and also purchased cooling equipment which was attached to the new machine for its smooth functioning. (4)

(b) Mr. Saulat acquired production machinery by utilizing a loan repayable in euro. The loan is expressed in rupees and is repayable in two years' time. Mr. Saulat also received 20% subsidy on such machinery from the Provincial Government. (4)

(c) On 1 July 2015 Mr. Talha started using his personal computer for business purposes. He also had to upgrade the operating system to comply with his business needs. (2)

(d) Mr. Rahi constructed a furnace for his factory in Korangi Industrial Area. (2)

(Q.2 September 2015)

Question-35

Akram has recently established an advertising agency in the name and style of Azad Advertising. For introducing his business to both international and local clients, he has allocated considerable chunk of his marketing budget to entertainment expenditures. Under the Income Tax Ordinance, 2001 and Rules made thereunder, advise Akram about the prescribed limits/conditions for the deduction of entertainment expenditure. (07)

(Q.2 March 2016)

Question-36

Under the provisions of Income lax Ordinance, 2001 certain persons are required to pay minimum tax at the rate of 1.25% of their turnover.

Required:

(i) Explain the term 'Turnover' for the purpose of minimum tax. (5)

(ii) List the persons who are required to pay minimum tax. (3)

(iii) Discuss the rules relating to carry forward of minimum tax paid to the subsequent years. (2)

(Q.3 (a) September 2011)
(Q.5 September 2017)

Question-37

Explain the term 'disposal of assets' as referred to in the Income Tax Ordinance, 2001. (05)

(Q.2 (a) March 2017)

Question-38

Under the provisions of the Income Tax Ordinance, 2001 compute taxable income or loss, under the correct head of income for tax year 2027, in each of the following cases:

(i) Sarwar Enterprises sold an immovable property for Rs. 50 million. The cost of the immovable property was Rs. 30 million. Tax depreciation of Rs. 6 million had been allowed on the immovable property up to the date of disposal. (2.5)

(ii) Shams Industries Limited (SIL) sold and exported one of its plants to a Nigerian Company. The sale proceeds received in SIL's account amounted to Rs. 25 million. The cost and tax written down value of the plant at date of disposal was Rs. 20 million and Rs. 7 million respectively. (2.5)

(Q.3 (c) and (d) September 2017)

Question-39

a) Hirani & Company (HC), a resident AOP, is engaged in selling various consumer products and is assessed under normal tax regime. During the year ended 30 June 20X8, HC's sales was Rs.140,000,000. It includes sales tax of Rs. 10,000,000 and excise duty of Rs. 5,000,000. The taxable income for the year is Rs. 6,170,000.

Compute HC's tax liability for tax year 20X8, under the provisions of the Income Tax Ordinance, 2001. (03)

b) The accounting profit before tax of Bashir Associates (BA) for the year ended 30 June 20X8 is Rs.1,200,000. Last year, BA had written off balances outstanding from two of its debtors namely Pulse International (PI) and Hussain Global (HG) which were partly allowed by the tax authorities. Details are as follows:

	PI	HG
	------ Rupees ------	
Amounts written off	1,150,000	925,000
Allowed by tax authorities	825,000	240,000

During the current tax year, BA received Rs. 652,000 from PI and Rs. 346,000 from HG, in full settlement of their debts.

In the light of the Income Tax Ordinance, 2001 compute BA's taxable income for the tax year 20X8. (05)

(Q.3 (a), (b) September 2018)

Question-40

Following transactions pertain to Salam Limited (SL) which took place during the tax year 20X9:

(i) A machine costing Rs. 1,800,000, being used in SL's Karachi factory was transferred to its subsidiary in Ghana. The fair market value and tax written down value of the machine on the date of transfer were Rs.2,500,000 and Rs. 600,000 respectively. (02)

(ii) On 1 January 20X9, SL entered into a forward contract for the purchase of raw materials to be used in its business to guard against loss through price fluctuations. On the date of maturity of the forward contract, SL did not take the delivery of the raw materials but the contract was settled by making a payment of Rs.500,000. (03)

Required:

Explain the taxability of the above transactions. **(Q.3 (b) March 2019)**

Question-41

a) Sikandar has revalued his factory building in accordance with International Financial Reporting Standards and consequently charged depreciation on the revalued amount. ***Explain the tax implication of the revaluation.*** (02)

b) Shahbaz has acquired machinery for his new factory against a loan repayable in USD. ***Discuss what would be the cost of machinery for the purpose of depreciation deduction.*** (02)

(Q.3 (c) (d) September 2019)

Question-42

During the tax year 2029, Salman Shahid sold the following assets:

A vehicle used by manager-in-charge of his garment factory for Rs. 2.8 million. The vehicle was purchased for Rs.3.1 million in tax year 2027. (03)

Required:

Under the provisions of the Income Tax Ordinance, 2001 compute under the appropriate head of income, the amount to be included in the taxable income of Salman Shahid for the tax year 2029.

(Q.5 (b) September 2019)

Question-43

Identify any three situations in which the fair market value of the assets shall be treated to be the cost of the asset. (03)

(Q.5 (a) September 2019)

Question-44

Under the provisions of the Income Tax Ordinance, 2001 and Rules made thereunder, discuss the prescribed limits conditions for the deduction of entertainment expenditure. (06)

(Q.3 (a) March 2020)

Question-45

Respond to the following situation, under the provisions of the Income Tax Ordinance, 2001:

On 1 July 2014, Ahmed purchased two sculptures for Rs. 410,000 and Rs. 475,000 respectively. On 30 November 2019, during the shifting of his house, he lost both the sculptures. On 15 January 2020, he received insurance claim of Rs. 940,000 in a single transaction against the loss of two sculptures. The fair market value of both the sculptures at the time of loss was estimated at Rs. 360,000 and Rs. 540,000 respectively. ***Compute Ahmed's taxable income or loss for the above transaction.*** (04)

(Q.4 (b) March 2020)

Question-46

(a) What do you understand by the term 'Turnover' as provided in section 113 of the Income Tax Ordinance, 2001? List the persons who are required to pay minimum tax on the basis of turnover. **(08)**

(b) Gillani and Company (GC), a sole proprietor, is dealing in various consumer products in Pakistan. During the year ended 30 June 20X2, GC's taxable income for the year was Rs. 6.1 million.

Required:

Under the provisions of the Income Tax Ordinance, 2001 compute the amount of net income tax payable by GC and amount of income tax to be carried forward, if any, for the tax year 20X2, in each of the following situations:

(i) GC's sales were Rs. 120,500,000 inclusive of sales tax.

(ii) GC's sales were Rs. 110,000,000 inclusive of sales tax. **(05)**

(Q.2 March 2021)

ICAP PAST PAPER SOLUTIONS

Answer-1

i) Resident person will pay tax on his foreign source income and Pakistan source income. However he will avail the tax credit, if he has paid the foreign income tax on foreign source income.
Non-resident person will pay tax on Pakistan source income.

ii) Revenue expenditure is allowed as deduction in the year in which is incurred, if it is a tax allowable expense.
Capital expenditure will be allowed as deduction as enumerated in section 22 and 24. Give the examples of depreciable assets and intangible assets yourself.

iii) Section 53.

Answer-2

a) S. 18

b) S. 21

c) - Types/Methods S. 31(1),(2)
- If the taxation officer is not satisfied that the change is necessary to clearly reflect the person's income chargeable to tax under the head "Income from Business", he may not accept.

Answer-3

i. Following are the conditions [S.28(1)(b)]:
   a. lease rentals are incurred by a person in the tax year to a scheduled bank, financial institution, an approved modaraba, an approved leasing company or a Special Purpose Vehicle on behalf of the Originator
   b. The asset is used by the person for the purposes of business

ii. The proceeds or benefit of the debt have been used by the person for the purposes of business. [S.28 (1) (a)].

iii. Following are the conditions:
   a. Tax has been withheld on the salary if the salary income of employee exceeds Rs. 600,000. [S.21(c)]
   b. Monthly salary exceeding Rs. 25,000 is paid either by a crossed cheque or direct transfer of funds to the employee's bank account.[S.21(m)]

iv. Any contribution made to a recognized provident fund or approved gratuity fund shall be allowed as deduction to the taxpayer if he has made effective arrangements to secure that tax will be deducted under section 149 from any payments made by the fund.
Any contribution made to an unrecognized provident fund or unapproved gratuity fund is not allowed as deduction under any condition.

v. There is no condition. All perquisites paid to employees are allowed as deduction as far as they incurred wholly and exclusively for business purpose.

Answer-4

Where a person has been allowed a deduction for any expenditure incurred in deriving income chargeable to tax under the head "Income from Business" and the person has not paid the liability or a part of the liability to which the deduction relates within three years of the end of the tax year in which the deduction was allowed, the unpaid amount of the liability shall be chargeable to tax under the head "Income from Business" in the first tax year following the end of the three years. [S.34 (5)].

Answer-5

a) The expense is admissible being wholly and exclusively incurred for the purposes of business.[S.20(1)]

b) The expense is admissible being wholly and exclusively incurred for the purposes of business.[S.20(1)]

c) Pre-commencement expenditure shall be amortized on a straight- line basis at the rate of 20%.[S.25(2)]

d) A person shall be **allowed a deduction for a bad debt in a tax year** if the following conditions are satisfied, namely:-
   (a) the amount of the debt was previously **included in the person's income** from business chargeable to tax
   (b) the debt or part of the debt is written off in the accounts of the person in the tax year; and
   (c) there are reasonable grounds for believing that the debt is irrecoverable. [S.29]

Answer-6

a) Not allowed as deduction as per S.21(a)

b) Any expenditure incurred in the acquisition of any depreciable asset or intangible or in the acquisition of immovable property will not be allowed as deduction. Rather we will allow the depreciation or amortization as the case may be.[S.26(2)]

c) If an amount is paid by a person in the tax year to a banking company under a scheme of musharika representing the bank's share in the profits of the musharika it will be allowed as deduction.[S.28(1)(h)]

d) Where an AOP pays any profit on debt to its member it will not be allowed as deduction.[S.21(j)]

e) A monthly payment of salary which is equal to or less than Rs. 25,000 paid otherwise than through cross cheque will be allowed as deduction.

Answer-7

a) Any lease rental paid by a person in the tax year to a scheduled bank is allowed as deduction if an asset is used by the person for the purposes of business. The lease rental comprises of principal and interest, therefore principal being an integral part of rental is allowed as deduction. [S.28(1)(b)]

b) Sales tax paid for production of exempt supply is an un-adjustable tax and it not levied on the profits and gains of business, therefore it is allowed as deduction. [S. 21(a)]
(Note: Do this question after reading sales tax)

c) Divided paid to shareholders is not an expense of the business.

d) Provision is not a tax allowable expense, rather actual bad debts incurred are allowed as deduction which is subject to certain conditions.

e) Any penalty paid by the person for the violation of any law, rule or regulation will not be allowed as deduction. So penalty levied under ITO, 2001 being penalty levied under a law will not be allowed as deduction.

Answer-8

[Note for students: Write in letter format and give the examples given in income from business Notes]

- A single payment exceeding Rs. 25,000 made in cash will not be allowed as deduction if the total of account head to which it relates exceeds Rs. 250,000 in a tax year.
- Following expenditures are allowed as deduction even if they are being paid in cash, irrespective of the amount of payment involved: [S.21(l)]
  (vi) utility bills;
  (vii) freight charges;
  (viii) travel fare;
  (ix) postage; and
  (x) payment of taxes, duties, fee, fines or any other statutory obligation.
- Monthly payment of salary of greater than Rs. 25,000 paid in cash will not be allowed as deduction.

Answer 9

b) A company shall account for income chargeable to tax under the head "Income from Business" on an accrual basis.[S.32(2)]

c) Provisions relating to change in method of accounting

(6) A person may apply, in writing, for a change in the person's method of accounting and the Commissioner may, by order in writing, approve such an application but only if satisfied that the change is necessary to clearly reflect the person's income chargeable to tax under the head "Income from Business".[S.32(4)]

(7) If a person's method of accounting has changed, the person shall make adjustments to items of income, deduction, or credit, or to any other items affected by the change so that no item is omitted and no item is taken into account more than once.[S.32(5)]

Answer 10

a) Any lease rental paid by a person in the tax year to a scheduled bank will be allowed as deduction provided the asset is used by the person for the purposes of business. Therefore Rs. 96,890 will be allowed as deduction. [S.28(1)(b)]

b)

	Treatment	Calculation	Deduction allowed
1)	It is a pre-commencement expenditure and will be amortised on S.L @ 20% per annum [S.25(2)]	50,000 x 20%	10,000
2)	It is a pre-commencement expenditure and will be amortised on S.L @ 20% per annum[S.25(2)]	100,000 x 20%	20,000
3)	It is a depreciable asset and it will be depreciated.[S.15(1)]	Initial allowance (150,000x25%) = 37,500 and depreciation (112,500x15%x50%) =8,438	45,938
4)	It is a depreciable asset and it will be depreciated.[S.15(1)]	Initial allowance (1,000,000x25%) = 250,000 and depreciation (750,000x15%x50%) = 56,250	306,250
5)	It is a pre-commencement expenditure and will be amortised on S.L @ 20% per annum[S.25(2)]	200,000 x 20%	40,000
6)	It is assumed that installation cost is for machinery .It will be depreciated. [S.76(2)]	Initial allowance (50,000x25%) = 12,500 and depreciation (37,500x15%x50%) =2,813	15,313
Total			**437,501**

Answer-11
Deleted

Answer-12

a) A person accounting for income chargeable to tax under the head "Income from Business" on an accrual basis shall incur expenditure when it is payable by the person. An amount shall be payable by a person when all the events that determine liability have occurred and the amount of the liability can be determined with reasonable accuracy.[S.34(1),(2)]

b) Costing method

A person accounting for income chargeable to tax under the head "Income from Business" on an accrual basis shall compute the person's cost of stock-in-trade on the absorption-cost method. [S.35(5)]

"absorption-cost method" means the generally accepted accounting principle under which the cost of an item of stock-in-trade is the sum of direct material costs, direct labour costs, and factory overhead costs;

Stock valuation method

A person accounting for income chargeable to tax under the head "Income from Business" on an accrual basis shall use FIFO or average cost method.

"average-cost method" means the generally accepted accounting principle under which the valuation of stock-in-trade is based on a weighted average cost of units on hand;

"first-in-first-out method" means the generally accepted accounting principle under which the valuation of stock-in-trade is based on the assumption that stock is sold in the order of its acquisition;

Answer-13

a) S. 23(5)

b)

Assets	Rate of depreciation [S.22]
Factory Buildings	10%
Residential quarter or labour	10%
Furniture	15%
Plant and machinery – general	15%
Computers and hardware	30%
Technical books	15%
New ships	15%
Motor vehicle	15%

If a depreciable asset is used in the person's business for the first time in a tax year commencing on or after the 1st day of July 2020 depreciation deduction shall be reduced by fifty percent.

Answer-14

S. 27

Answer-15

S. 29 (1),(2)

Answer-16

List down any five mentioned in Section 21.

Answer-17

S. 23(5)

Answer-18

a)]

(i) Any fine or penalty paid by the person for the violation of any law, rule or regulation is not allowed as expense therefore it is an inadmissible expense. [S.21(g)]

(ii) As a general rule every expenditure under a single account head which in aggregate exceeds Rs. 250,000 will not be allowed as deduction if it is paid in cash. However freight is an exception to this rule, therefore it is tax allowable expense. [S.21(l)]

(iii) If the salary income of employee exceeds Rs. 600,000, Tax should be withheld on it, otherwise it will not be allowed as deduction.[S21(c)]

b)

> Majority of the candidates explained the valuation of stock-in-trade through FIFO and average cost method instead of explaining the basis of computation i.e. prime cost method or absorption cost method as referred to in section 35 (5).

A person accounting for income chargeable to tax under the head "Income from Business" on a cash basis may compute the person's cost of stock-in-trade on the prime-cost method or absorption-cost method. [S.35(5)]

"absorption-cost method" means the generally accepted accounting principle under which the cost of an item of stock-in-trade is the sum of direct material costs, direct labour costs, and factory overhead costs;

"prime-cost method" means the generally accepted accounting principle under which the cost of stock-in-trade is the sum of direct material costs, direct labour costs, and variable factory overhead costs;

c) S. 29(3)

Answer-19
S. 22(15)

Answer-20
The performance of the candidates was average. Many candidates were able to mention that income should be accrued when it become due to the person and expenditure is accrued when it becomes payable by the person. However they didn't explain further as to when the income becomes due and when the expenditure becomes payable.

S.34 (1), (2), (3)

Answer-21
This was an easy question but it was surprising to see that majority of the candidates were unaware of the treatment of accounting profit on disposal of fixed assets and reversal of provision of doubtful debts which is taught repeatedly at the foundation level. The answers relating to dividends received and profit on debts were however satisfactory.

(i) It will be deducted from accounting profit while calculating taxable income.
(ii) As provision is added back when charged for not being allowed as tax expense. So in case of reversal we will deduct it from accounting profits.
(iii) The tax deducted on dividend received by AOP is a final tax and it will not be added in the members share of profit from AOP.

Answer-22
It was a straightforward question of four marks but surprisingly very few seemed to have read Sections 35(2) & 35(4). Most of the examinees got confused and explained the valuation of stock as mentioned in Sections35 (5) & 35(6) of the ITO 2001.
Opening stock S.35 (2), (3) and Closing stock S.35 (4),(5),(6)

Answer-23
S. 23(5) (a-d)

Answer-24
i) As a general rule every expenditure exceeding Rs. 25,000 incurred under a single account head which in aggregate exceeds Rs. 250,000 will not be allowed as deduction if it is paid in cash. However utility is an exception to this rule, therefore it is tax allowable expense.[S.21(l)]
ii) Any fine or penalty paid by the person for the violation of any law, rule or regulation is not allowed as deduction therefore penalty paid for late submission of quarterly statement will not be allowed as deduction. [S.21(g)]
iii) <u>Any lease rental paid</u> by a person in the tax year to a scheduled bank is allowed as deduction, therefore depreciation will not be allowed as deduction. [S.28(1)(b)]

Answer-25
i) S. 29 (1),(2)
ii) S. 16 (1),(2) and (3)
iii) S. 19(1)

Answer-26
i) The commission paid to an employee falls under the definition of salary. Therefore Mr. Sajid should have deducted the tax on it. As he has not deducted the tax, therefore the commission expense will not be allowed as deduction while calculating business income.[S.21(c)]
ii) As per the provisions of law any personal expenditures incurred by the person is not allowed as deduction. Therefore he cannot claim Rs. 50,000 as deduction while calculating income from business.[S.21(h)]
iii) No initial allowance is allowed on vehicle purchased[S.23(5)], however he can claim only such portion of depreciation as is attributable to business because as per the provision of law where an asset is used partly in deriving income from business and partly for another use, the depreciation deduction will be allowed on proportionate basis.[S.22(3),(6)]

iv) The intangible will be amortised over its useful life of 12 years, therefore Rs. 37,295 {(900,000/12) x 182/366} will be allowed as deduction in TY 2008.[S.24(4)]

v) Following amount will be added in income:

Amount received from Government		400,000
Less: Actual amount of loss	500,000	
Less: Loss previously allowed as deduction	(350,000)	(150,000)
Amount to be added in income for TY 2008		**250,000**

Its treatment is same as the treatment of bad debt recovery as per section 29.

vi) As per the provisions of law any cess, rate or tax paid by the person in Pakistan or a foreign country that is charged on the profits or gains of the business or assessed as a percentage or otherwise on the basis of such profits or gains is not allowed as deduction. Professional tax of Rs. 100,000 paid to the Government of Punjab not being tax on profits will be allowed as deduction.[S.21(a)]

Answer-27

Deleted

Answer-28

a) A tangible movable or immovable asset will be considered a depreciable asset when all the following conditions are met: [S.22(15)]

- It has a normal useful life exceeding one year;
- It is likely to lose value as a result of normal wear and tear, or obsolescence;
- It is used wholly or partly by the person in deriving income from business chargeable to tax.

b)

i)

		Rs. In '000'
Consideration received		200,000
Less: Tax WDV		
Cost	200,000	
Accumulated depreciation	(10,000)	(190,000)
Tax gain on disposal		10,000

ii)

	Rs. In '000'
Consideration received	25,000
Less: Tax WDV	(18,000)
Tax gain on disposal	7,000

Answer-29

(i) The firm cannot claim deductions on account of bad debts unless the following conditions are satisfied:[S.29(1)]

- the amount of debt was previously included in the person's income from business chargeable to tax;
- the debt or part of the debt is written off in the accounts of the person in the tax year;
- there are reasonable grounds for believing that the debt is irrecoverable.

(ii) Since the liability pertaining to the year 2006 has been charged/ (added back) to tax therefore subsequent payment thereof shall be allowed as a deduction, in the year in which the payment is made i.e. 2009.

(iii) The firm can claim the initial allowance against the imported used plant as:

- it is used in Pakistan for the first time in a tax year. [S.23(1)]
- it is used by the firm for the purposes of its business it falls in the definition of eligible depreciable asset

Answer-30

Comments on the deductibility of expenditures charged by CL:

(i) **Amortization of intangibles**:
Any expenditure that provides an advantage or benefit for a period of more than one year is included in the definition of intangibles and is required to be amortized over the period of expected benefit that is 12 years.[S.24(11),(4)]
As such CL would be allowed to charge Rs. 37,500 (450,000/12) in tax year 20X2.

(ii) **Bad debts**:
Only those bad debts are allowed as admissible deductions which have previously been included in the taxpayer's business income chargeable to tax.[S.29(1)(a)]
Since the staff loan was not previously offered to tax as business income, it would not be admissible.

(iii) **Initial depreciation**:
Initial allowance is only admissible on such plant and machinery which was not previously used in Pakistan.
Since in this case, the equipment was previously used in Pakistan, the initial allowance is not admissible.[S.23(c)]

(iv) **Vehicle on finance lease**:
Entire lease rentals paid during the year, on leased assets, i.e. Rs. 400,000 shall be allowed as admissible deduction.[S.28(1)(b)]
Following expenditures however, would not be admissible:
- Finance charges 100,000
- Depreciation 300,000

Answer-31

(a) S. 24(11)
(b) S. 24 (1) to (10)

Answer-32

(a)
(1) company shall account for income under the head "Income from Business" on an accrual basis,
(2) Other persons may account for such income on a cash or accrual basis. [S.32(2)]

(b)
(1) A person may apply for a change in the person's method of accounting and the Commissioner may, by order, approve such an application but only if satisfied that the change is necessary to reflect the person's income under the head "Income from Business".[S.32(4)]
(2) If a person's method of accounting has changed, the person shall make adjustments to items of income, deduction and credit, so that no item is omitted and no item is taken into account more than once. [S.32(5)]

Answer-33

Following are the situations: [S.75]

(1) An asset will be considered as disposed off when its ownership comes to an end, including when it is:
(a) sold, exchanged, transferred or distributed; or
(b) cancelled, destroyed, lost, expired or surrendered.

(2) The transmission of an asset by succession or will shall be considered as disposal at the time of transmission.

(3) The application of a business asset to personal use will be considered as disposal when asset is put to personal use.

(3A) Where a business asset is discarded or ceases to be used, it will be considered that it is disposed off.

(4) A disposal shall include the disposal of a part of an asset.

Answer-34

(a) The cost of new purchased machine shall be the sum of following amounts:

(a) The total amount given for asset, including FMV of consideration in kind determined at the time the asset is acquired.

(b) Any incidental expenditure paid in acquiring and disposing of asset.

(c) Expenditure paid to alter or improve the asset. For example, the cooling equipment purchased here.

(b) As per S. 76 (5) and (10) if an asset is purchased with a loan from foreign currency, then any increase/decrease in liability due to currency fluctuation will be added or deducted in the cost of the asset. For the calculation of depreciation, currency fluctuation will be accounted for in year of occurrence.

The cost of an asset does not include the amount of any subsidy received in respect of the acquisition of the asset. However if subsidy is chargeable to tax then it will be added in cost.

(c) As per S.76 (3) if a personal asset is put to business use, its cost will be the fair market value on the date it is put to business use and as per S.76 (2) (c), the cost shall include expenditure paid to alter or improve the asset. Therefore, the cost of personal computer shall be sum of FMV on 1st July, 2015 and cost of up gradation.

(d) As per S.76 (4) the cost of self-constructed furnace shall be the total cost incurred in producing or constructing the asset plus any incidental expenditure paid to alter or improve the asset.

Answer-35

Limits for deduction of entertainment expenditure

As per Rule 10 of Income Tax Rules 2002, A deduction for entertainment expenditure shall be allowed if the expenditure is incurred wholly and exclusively for the purposes of business and is-

(a) incurred outside Pakistan on entertainment for business transactions or where expenditure is allocated as head office expenditure;
(b) incurred in Pakistan on entertainment of foreign customers and suppliers;
(c) incurred on entertainment of customers at the person's business premises;
(d) incurred at a meeting of shareholders, agents, directors or employees; or
(e) incurred at the opening of branches.

Any entertainment expenditure, exceeding above limits, shall not be allowed as deduction under the head 'Income from Business'

Answer-36

i) S. 113(3)

ii)
- A resident company
- permanent establishment of a non-resident company
- an individual having turnover of 100 million rupees or above in the tax year 2017 or in any subsequent tax year and
- an association of persons having turnover of 100 million rupees or above in the tax year 2017 or in any subsequent tax year

is required to pay this tax.

iii) Where tax paid at 1.25% of turnover exceeds the actual tax payable (calculated in normal way), the excess amount of tax paid shall be carried forward for adjustment against actual tax liability of the subsequent 5 tax years. The 5 years will start from the end of the year for which minimum tax is paid.

Answer-37

Following assets will be considered as disposed off: [S.75]

(1) An asset will be considered as disposed off when its ownership comes to an end, including when it is:

(a) sold, exchanged, transferred or distributed; or

(b) cancelled, destroyed, lost, expired or surrendered.

(2) The transmission of an asset by succession or will shall be considered as disposal at the time of transmission.

(3) The application of a business asset to personal use will be considered as disposal when asset is put to personal use.

(3A) Where a business asset is discarded or ceases to be used, it will be considered that it is disposed off.

(4) A disposal shall include the disposal of a part of an asset.

Answer-38

(i) **Sarwar Enterprises**
Income from business

		'Rs. in million'
Consideration received		50
Less: Tax written down value		
Cost	50	
Less: Accumulated Depreciation	(6)	(44)
Gain		6

(ii) **Shams Ltd.**
Income from business

	'Rs. In million'
Consideration (restricted to cost) [S. 22(14)]	20
Less: Tax written down value	(7)
Taxable gain on disposal	13

Answer-39

a) Minimum tax on income will be applicable as Hirani & Company is a Resident AOP having turnover more than Rs.100 million.

			Rupees
Income tax payable under Normal Tax Regime (NTR)			
Taxable income			6,170,000
Income tax on above (Table 1) (1,220,000 + 35% x 170,000)		A	1,279,500
Income Tax payable under minimum tax regime			
Gross sales	(140,000,000 -10,000,000 – 5,000,000)		125,000,000
Tax u/s 113 @ 1.25% on Rs. 125,000,000		B	1,562,500
Tax liability of HC (higher of **A** and **B**)			1,562,500

Tax of Rs. 283,000 (1,562,500 – 1,279,500) will be carried forward for adjustment against actual tax liability of the subsequent **5 tax years.**

b)

Bashir Associates
Taxable Income
TY 20X8

				Rupees
Accounting profit				1,200,000
Less:	Amount received from Pulse International			(652,000)
Less:	Amount received from Hussain Global			(346,000)
Add:	Tax Bad debt recovery – PI	**[S.29 (3) (a)]**	**(W-1)**	327,000
Less:	Tax Bad debt – HG	**[S.29 (3) (a)]**	**(W-2)**	(339,000)
Taxable income				**190,000**

(W-1) Bad debt recovery-PI

		PI
Amount received		652,000
Less: Actual amount of bad debt	1,150,000	
Less: Previously allowed as deduction	(825,000)	(325,000)
		327,000

(W-2) Bad debt recovery-HG

		HG
Amount received		346,000
Less: Actual amount of bad debt	925,000	
Less: Previously allowed as deduction	(240,000)	685,000
		(339,000)

Answer-40

i) If a person exports or transfers out of Pakistan a depreciable asset used in Pakistan, it will be assumed that person has disposed of the asset for a consideration equal to the cost of the asset.
As asset has been transferred by SL's Karachi factory to its subsidiary in Ghana, it would be considered as disposal of asset as machine has been transferred out of Pakistan. The amount calculated as follows would be included in taxable income of SL:

Consideration (equal to cost of asset)	1,800,000
Less: Tax written down value	(600,000)
Amount to be included in taxable income as gain under the head income from business	1,200,000

ii) "Speculation business" means a business in which a contract for the purchase and sale of a commodity is not settled by actual delivery of commodity.

However if a contract for stock is made by a person during mercantile business to guard against loss through future price fluctuations for fulfilling the person's other contracts for the actual delivery of the goods will not be considered as speculative business

As SL has entered into a forward contract for the purchase of raw material to be used in its business to guard against loss through price fluctuations, therefore Rs. 500,000 paid (being loss on transaction) for the settlement of contract would be allowed as deduction from income from business non-speculation in tax year 20X9.

Answer-41

a) Accounting revaluation of factory building will not affect tax written down value. Consequently, depreciation will be allowed on tax written down value of building and we will ignore the effect of revaluation.

b) If an asset is purchased with a loan from foreign currency, then any increase/decrease in the liability (before repayment) due to currency fluctuation will be added/deducted in the cost of the asset. For the calculation of depreciation, currency fluctuation will be accounted for in year of occurrence. As Shahbaz has acquired the new factory against a loan repayable in USD, any increase/decrease in the liability (before repayment) due to currency fluctuation will be added/deducted in the cost of factory.

Answer-42

Tax gain / (loss) TY 2029		Rupees
Consideration received	[S.22(13)(a)] $\left[2{,}800{,}00 \times \frac{2{,}500{,}000}{3{,}100{,}000}\right]$	2,258,065
Less: Tax written down value	(W-1)	(1,818,203)
Income from business		439,862

(W-1)

Cost of vehicle		2,500,000
Less: Depreciation	(2027) (2,500,000 x 15% x 50%)	(187,500)
WDV	(2027)	2,312,500
Less: Depreciation	(2028) (2,312,500 x 15%)	(346,875)
WDV	(2028)	1,965,625
Less: Depreciation	(2029) (1,965,625 x 15% x 50%)	(147,422)
WDV	(2029)	1,818,203

Answer-43

The fair market value of the assets shall be treated as cost of the assets when received:

- under a gift from a relative, bequest or will;
- by succession, inheritance or devolution;
- on a distribution of assets on dissolution of an association of person; or
- on a distribution of assets on liquidation of a company [S.37(4A)]

The cost of a personal assets treated as acquired by the business shall be the fair market value of the asset determined at the date it is applied to business use. [S.76(3)]

Answer-44

Same as Answer-35.

Answer-45

Income from Capital Gain

Sculpture 1

				Rupees
Consideration	[360,000/900,000) x 940,000]	[S.77(5)]	376,000	
Less: Cost of purchase			(410,000)	

Sculpture 2

Consideration [540,000/900,000) x 940,000]		[S.77(5)]	564,000	
Less: Cost of purchase			(475,000)	
Gain / (loss)			89,000	
Holding period more than 1 year		(89,000 x 75%)		66,750
Taxable income				66,750

Answer-46

(a) **For "Turnover"** definition Refer Section 113(3)

Following persons are required to pay minimum tax:

- a resident company
- permanent establishment of a non-resident company
- an individual having turnover of 100 million rupees or above and
- an association of persons having turnover of 100 million rupees or above.

(b)

(i)

			Rupees
Income tax payable under Normal Tax Regime (NTR)			
Taxable income			6,100,000
Income tax on above (Table 1) (1,220,000 + 35% x 100,000)		A	1,255,000
Income Tax payable under minimum tax regime			
Gross sales	(120,500,000/117) x 100		102,991,453
Tax u/s 113 @ 1.25% on Rs. 102,991,453		B	1,287,393
Tax liability of GC (higher of A and B)			1.287,393
Income tax to be carried forward (1,287,393 – 1,255,000)			32,393

(ii)

			Rupees
Income tax payable under Normal Tax Regime (NTR)			
Taxable income			6,100,000
Income tax on above (Table 1) (1,220,000 + 35% x 100,000)		A	1,255,000
Income Tax payable under minimum tax regime			
Gross sales	(110,000,000/117) x 100		94,017,094
As the turnover of GC is less than Rs. 100 million, so minimum tax will not be applicable		B	-
Tax liability of GC			1,255,000

PRACTICE QUESTIONS

Question-1

Mr. Qasim has prepared the following profit and loss:

		Rs. mill.	Rs. mill.
Sales			25
Less:	Expenses		
	Salaries	10	
	Penalty paid to government	3	
	Repair	6	
	Depreciation	2	(21)
			4
Add:	Other income		
	Gain on sale of furniture		3
Net profit			7

(i) Tax depreciation is Rs.4 mill.

(ii) Tax gain on sale of furniture is Rs. 5 mill.

(iii) No tax was deducted on salaries of Rs.4 mill.

Required:

Calculate taxable income?

Question-2

Mr. Noor is a resident individual. His income statement for the year ended 30 June 2021 shows an accounting profit before tax of Rs. 2,000,000, after taking into account the following items:

		Rs.
Expenses/deductions		
Depreciation		1,100,000
Salaries expense	(i)	2,000,000
Purchase of computer software		900,000
Loss on the sale of a computer		10,000
Others expenses		1,000,000
Income		
Gain on sale of office building		1,200,000
Bad Debt recovery		50,000

Unless stated otherwise, Mr. Noor paid for all the expenses through crossed cheques and tax was deducted and deposited as required under the law.

i. Salaries expense consisted of six months' salary of a worker, at Rs. 30,000 per month, paid in cash.
ii. Noor purchased computer software at a cost of Rs. 900,000 on 1 March 2021. The useful life of the software is estimated to be five years
iii. Other expenses include:
   - Electricity bills of Rs. 700,000 paid in cash
   - Professional tax paid at Rs. 200,000 to the Government of Punjab. The tax is payable annually irrespective of the income of the company
   - A fine of Rs. 50,000 paid for violation of the regulations issued by the Securities and Exchange Commission of Pakistan (SECP).

iv. Fixed assets used for business

Sr. No.	Description of asset	Tax written down value (TWDV) on 1 July 2020	Added on 1 January 2021	TWDV on 30 June 2020 of the assets sold on 31 March 2021	Sale proceeds
		Rs.	Rs.	Rs.	Rs.
1.	Land	3,000,000	–	–	–
2.	Office building	1,000,000	–	100,000(N)	2,000,000
3.	Computers	200,000	100,000	30,000	65,000
4.	Furniture	300,000		–	–
5.	Plant and machinery	60,000	50,000	–	–

Note: The cost of the building sold was Rs. 800,000.

Other information

(i) In the tax year 2019, against a total bad debt claim of Rs. 200,000, the Commissioner allowed a deduction of Rs. 180,000. In the year ended 30 June 2021, He recovered Rs. 50,000 from the above amount of Rs. 200,000.

(ii) A trading liability of Rs. 240,000 was allowed in the tax year 2015 on an accrual basis. However, since it remained unpaid, the Commissioner disallowed it in the tax year 2019. The said trading liability has been paid in the tax year 2021.

Required:

Compute the taxable income of Mr. Noor for the tax year 2021.

Question-3

Mr. Riaz is doing the business of selling pesticides and has provided you following details for accounting year ended 30.06.2021.

(1) All amounts are stated in thousands of Rupees ('000 Rupees)

(2) The accounting profit after income tax for the year ended 30.6.2021 is Rs.10,500. Income tax is Rs. 3,500.

(3) Cost of sales include:

Expenditure of Rs.9,600 was incurred for in-house development and creation of a new process for the faster formulation of pesticides. The process has been used by Riaz since 1 May 2021. On the basis of the production manager's report that the process would be obsolete in three years, therefore accounting books show an expense of: (1/3 of Rs.9,600) — 3,200

Depreciation charged in the accounts — 1,125

(4) Administration expenses include:

Legal expenses incurred in defending the title of the building — 165

Legal costs incurred in defending Riaz for a traffic accident — 60

Purchases of items of furniture costing less than Rs.100 each charged off in the accounts, in accordance with the consistent accounting policy of the company. Purchases of such items in July 2020 amounted to — 750

(5) Selling and distribution expenses include:

Salary of sales staff on which tax is not deducted — 1,600

(6) Other income includes:

Recoveries against bad debts written off in prior years which were allowed as a deduction — 250

(7) Creditors include Rs. 900 rent expense payable which was allowed as a deductible charge in the income year ended 30 June 2017.

(8) Fixed assets

(i) In the tax year 2020, a second hand mixing machine which had not previously been used in Pakistan was imported from the UK for Rs. 2,500. Due to some major renovations required before the machine could be used in the business, the machine could not be commissioned for use in the tax year 2020. In July 2020, the necessary renovations costing Rs. 576 were completed and the machine was commissioned for use in the month of July 2020. The renovation cost of Rs.576 has been included in the 'Cost of sales'.

(ii) The tax written down values of the fixed assets on 1 July 2020 were:

Factory buildings	2,500
Office buildings	8,200
Plant and machinery	9,500
Motor vehicles	400
Furniture	250

(iii) One of the office buildings (cost Rs.5,000 and tax written down value Rs.3,200) was sold on 30 June 2021 for Rs.6,000. The accounting profit of Rs.1,045 on the sale of the building has been included in 'Other income'.

(iv) A new motor vehicle was purchased on 1 July 2020 for Rs.2,600

Required:
Compute the taxable income of Mr. Riaz for the relevant tax year giving clear explanations for the items excluded in the computation for T.Y 2021.

Question-4
Mr. Wheels is engaged in the selling of motor cars. The following information is available for the accounting year ended 30 June 2021.

(1) Accounting profit for the year ended 30 June 2021 is Rs. 20,000,000

(2) Deductions charged in the accounts include:

		Rupees
(i)	Accounting depreciation	6,000,000
(ii)	Donation to a relief fund established in Pakistan by the Federal Government	700,000
(iii)	Minor additions to plant	300,000

(3) Income shown in the accounts includes:

(i)	Accounting profit on the sale of a building	6,095,000
(iii)	Received against a debt written off in the tax year 2020, which was then not allowed as a deduction against taxable income	175,000

(4) Fixed assets:

(i) The tax written down values of fixed assets on 1 July 2020 were:

Buildings	13,800,000
Furniture and fitting	1,570,000
Plant and machinery	2,700,000
Motor vehicles	2,500,000

(ii) A deluxe motor car was purchased on 1 January 2021 for Rs. 6,000,000, for the Chief Executive.

(iii) One of the buildings (cost Rs. 10,000,000 and tax written down value Rs. 7,000,000) was sold on 30 June 2021 for Rs. 15,000,000.

(iv) An item of second-hand plant, not previously used in Pakistan, was imported from Japan at a cost of Rs. 3,500,000. Rs. 500,000 was incurred on the installation of the plant, which was commissioned for use on 1 January 2021. The Rs. 500,000 installation cost has been shown as revenue expenditure in the accounts.

(5) Creditors include:

(i) Rs. 3,000,000 payable in respect of a loan taken out for business purposes in the accounting year ended 30 June 2017. The Rs. 3,000,000 includes an amount of Rs. 400,000 profit payable on the loan, which amount was allowed as a deduction in the accounting year ended 30 June 2017.

(ii) Rs. 1,000,000 against repair expense payable outstanding from TY 2017.

(iii) Rs. 4,000,000 received in cash from Carsales Associates, a customer, as an advance payment for the sale of cars.

Required:
Compute the taxable income of Mr. Wheels for the relevant tax year under the appropriate heads of income. Your answer should give clear reasons/explanations for items excluded in the computation of taxable income.

Question-5

Mr. Waqar is engaged in the business of selling pharmaceuticals and its summarised accounts for the period from 1 January 2021 to 31 December 2021 are as follows:

	Notes	Rupees
Sales		98,000,000
Cost of sales	1	(69,500,000)
Gross profit		28,500,000
Less: Administration expenses	2	6,900,000
Less: Selling and distribution expenses	3	4,750,000
Less: Financial charges		2,250,000
Less: Write offs	4	300,000
Less: Income tax	5	1,100,000
		(15,300,000)
		13,200,000
Add: Other income	6	1,650,000
Net profit		14,850,000

The following additional information is provided:

(1) Cost of sales includes:

		Rupees
(i)	Accounting depreciation.	5,948,000
(ii)	Travel fare paid in cash	300,000
(iii)	Donation to a charitable hospital established by a private trust.	300,000

(2) Administration expenses include:

		Rupees
(i)	Accounting depreciation.	1,650,000
(ii)	Legal expenses in case against the business	725,000

(3) Selling and distribution expenses include a penalty of Rs. 650,000 paid to a customer in settlement of a claim for damages under a clause of a contract for the supply of a batch of influenza vaccines.

(4) The amount comprises:

	Rupees
Loan given to an employee written off	10,000
Trading debts written off	290,000

(5) Income tax represents a payment in discharge of a demand raised by the commissioner on completion of the tax audit for the tax year 2020.

(6) Other income includes:

		Rupees
(i)	Exempt income	550,000
(ii)	Excess provision for bad debts written back	100,000

(7) During the period from 1 January 2021 to 28 February 2021 Waqar incurred expenses on the construction of prototypes and trial production activities for a new product aggregating Rs. 3,000,000, which has been debited to the preliminary expenses account and is shown as an asset in the balance sheet as on 31 December 2021.

(8) Assets purchased during the tax year were:

Fixed assets	Rupees
Plant and machinery	17,500,000
Buildings	15,700,000
Motor cars	12,900,000
Furniture	18,750,000
Computers	20,900,000

(i) All the above assets are new assets except for the following which has been used previously in Pakistan:

– second-hand plant costing Rs. 10,000,000

(ii) The amount for computers of Rs. 20,900,000 is made up as follows:

	Rupees
Computer hardware	10,900,000
Computer software	10,000,000
	20,900,000

The computer software was acquired on 1 November 2021, but was not used by Mr. Waqar in its business chargeable to tax before 1 February 2022. The normal useful life of the software is estimated to be five years.

Required:

Compute the taxable income of Mr. Waqar for the relevant tax year under the appropriate heads of income, giving reasons/explanations for items excluded from the computation of taxable income.

PRACTICE QUESTIONS' SOLUTION

Answer-1

There are 2 ways of calculating taxable income:

S. No.	Ways	Approach
1.	Start from accounting profit (Backward working)	In this approach expenses which are not allowed by tax authorities are added back in accounting profit.
2.	Start from sale (Forward working)	In this approach expenses which are allowed by tax authorities are deducted from sale.

1. Backward Working

Income from business			Rs. in mill.
Net profit			7
Add:	Salaries	[S.21(c)]	4
	Penalty	[S.21(g)]	3
	Accounting depreciation		2
	Tax gain on sale of furniture		5
			14
Less:	Tax depreciation		4
	Accounting gain on sale of furniture		3
			(7)
Taxable Income			14

2. Forward Working

Income from business			Rs. in mill.
Sales			25
Less:	Expenses		
	Salaries	(10 – 4)	6
	Repair		6
	Tax Depreciation		4
			(16)
Add:	Tax gain from sale of furniture		5
Taxable Income			14

Answer-2

Mr. Noor
Taxable Income and Tax thereon
For Tax Year 2021

Income from business			Rs.	Rs.
Profit before tax				
Add:				2,000,000
Accounting depreciation			1,100,000	
Inadmissible salaries	[S.21(m)]	(30,000 x 6)	180,000	
Purchase of computer software	[S.21(n)]		900,000	
Accounting loss from sale of computer			10,000	
Tax gain on sale of computer	(W-1)		35,000	
Tax gain on sale of office building	(W-2) [S.22(13)(d)]		700,000	
Fine paid to SECP for violation of law	[S.21(g)]		50,000	
Tax Recovery of bad debt (W-4)	[S.29(3)(a)]		30,000	
				3,005,000
Less:				
Amortisation of computer software (900,000/5 x 122/366)			60,000	
Tax depreciation and Initial Allowance (W-3)			246,563	
Trading liability paid	[S. 34(6)]		240,000	
Accounting gain on sale of office building			1,200,000	
Accounting bad debt recovery			50,000	
				(1,796,563)
Taxable Income				3,208,437

Items not included in the computation of taxable income

i. Electricity expense can be paid in cash, so deduction is allowed.
ii. The amount of Rs. 200,000 paid as professional tax to the Punjab government is an allowable deduction as it is neither levied on the profits of the business nor assessed as a percentage on the basis of profits.

(W-1) Gain from the sale of the computer

	Rs.
Sale proceeds received	65,000
Tax WDV of the computer	(30,000)
Taxable gain	35,000

(W-2) Gain from the sale of the office building

	Rs.	Rs.
Consideration received		2,000,000
Cost	2,000,000	
Accumulated depreciation (800,000 – 100,000)	(700,000)	(1,300,000)
Tax Gain		700,000

(W-3) Depreciation calculation:

	Land	Office Building	Computers	Furniture	Plant and Machinery	Total
Rate		10%	30%	15%	15%	
On opening assets excluding disposals						
Written down value	3,000,000	1,000,000	200,000	300,000	60,000	
Less: Disposals	-	(100,000)	(30,000)			
	3,000,000	900,000	170,000	300,000	60,000	
Depreciation		90,000	51,000	45,000	9,000	195,000
On additions						
Cost			100,000		50,000	
Initial allowance			(25,000)		(12,500)	37,500
			75,000		37,500	
Depreciation (Rate x 50%)			11,250		2,813	14,063
Total depreciation and initial allowance						246,563

Note: No depreciation is calculated on disposals as these were purchased before 01.07.2020.

(W-4) Bad debt recovery:

		Rs.
Bad Debt recovered		50,000
Total bad debts in the tax year	200,000	
Amount previously allowed as a deduction	(180,000)	(20,000)
		30,000

Answer -3

(a)

Mr. Riaz
Taxable Income and Tax Thereon
Tax year 2021

			Rs."000"
Accounting profit			10,500
Add:			
Tax expense	[S.21(a)]	(Note 3)	3,500
Accounting amortisation of the cost of new process			3,200
Accounting depreciation			1,125
Legal costs (Drawings)	[S.21(h)]		60
Purchase of furniture	[S.21(n)]		750
Salary on which tax is not deducted	[S.21(c)]		1,600
Unpaid rent expense	[S.34(5)]	(Note 4)	900
Tax profit on sale of building	[S.22(13)(d)]	(Note 5)	1,800
Renovation cost of mixing machine	[S.21(n)]	(Note 6)	576
			13,511
Less:			
Amortisation of intangible	(9,600/3) x 61/366		533
Accounting profit on sale of a building			1,045
Tax Depreciation and initial allowance		(Note 8)	3,460
			(5,038)
Taxable Income			18,973

Items not included in the computation of income

(1) Legal expense of Rs. 165 in defending the title of the building is a deductible expense as it is in the normal course of business.

(2) Riaz has received Rs.250 against debts which were previously allowed as a deductible charge. Where any expenditure allowed as a deduction is received then the amount received is to be included in the income under the same head of income for the tax year in which it is received. Rs.250 is therefore chargeable to tax as income from business in the tax year 2004. [Recouped expenditure] [S.70]

(3) Income tax is not deductible. Any tax paid or payable that is leviable on the profits of the business is not a deductible charge. [s.21(a)]

(4) The unpaid expenditure of Rs.900 for rent was allowed as a deduction in the accounting year ended 30 June 2017. As the amount has remained unpaid for three years from the end of the year in which the deduction was allowed (30 June 2018, 2019, 2020) the amount is chargeable to tax in the tax year 2021 (the first year following the end of the said three years). [s.34 (5)]

(5) In the case of the disposal of any immovable property, where the consideration received on disposal exceeds the cost of the property, the sale consideration received is to be treated as the cost of the property.

Tax profit on disposal of building

		Rs."000"
Sale consideration		6,000
Less: Tax written down value		
Deemed cost	6,000	
Depreciation allowed (5,000 – 3,200)	(1,800)	(4,200)
Tax profit on sale of building		1,800

(6) Expenditure on renovations necessary at the time of purchase of an asset to render the asset capable of being used in the business is capital in nature and adds to the cost of the asset. Rs.576 is not deductible and has to be added to the cost of the machine.

(7) Initial allowance

		Rs"000".
Cost of mixing machine		2,500
Add: Cost of renovation	(Note 6)	576
		3,076
Initial allowance at 25%		769

Depreciation

Rate of depreciation	Plant and Machinery 15% Rs.	Factory Building 10% Rs.	Office Building 10% Rs.	Motor Vehicle 15% Rs.	Furniture 15% Rs.	Total Dept. Rs.
On opening assets excluding Disposals						
Written down value	9,500	2,500	8,200	400	250	
Disposal	–	–	(3,200)	–	–	
	9,500	2,500	5,000	400	250	
Depreciation	1,425	250	500	60	38	2,273
On additions						
Cost	3,076	–	–	2,500	750	
Initial allowance (Note 7)	(769)	–	–	–	–	769
Written down value	2,307	–	–	2,500	750	
Depreciation (Rate x 50%)	173	–	–	188	57	418
						3,460

The cost of the new car (Rs.2,600) has been restricted to Rs.2,500 for the purposes of claiming depreciation.

Note: No depreciation is calculated on disposals as these were purchased before 01.07.2020.

Answer-4

Mr. Wheels
Taxable Income and Tax Thereon
Tax year 2021

			Rs.
Computation of taxable income			
Income from business			
Accounting profit			20,000,000
Add: Accounting depreciation			6,000,000
Donation to a relief fund	[S.61(1)(b)]	(Note 3)	700,000
Additions to plant wrongly included in expenses	[S.21(n)]		300,000
Plant installation wrongly included in expenses	[S.21(n)]		500,000
Unpaid liability	[S.34(5)]	(Note 4)	400,000
Unpaid liability – repair	[S.34(5)]		1,000,000
Tax profit on the sale of the building	[S.22(13)(d)]	(Note 5)	3,000,000
			11,900,000
Less: Accounting profit on the sale of the building			6,095,000
Recovery of a debt previously written off		(Note 6)	175,000
Tax Depreciation and initial allowance		(Note 7)	3,199,875
			(9,469,875)
Taxable income			22,430,125

Items not included in the computation of taxable income

(1) Principal amount of loan of Rs.2,600,000(3,000,000-400,000) will have no impact because only those unpaid liabilities are added to income which were previously allowed as deduction. [S.34(5)]

(2) An advance received by a person from another person which is not paid by a crossed cheque or through a banking channel from a person holding a national tax number, is treated as the income chargeable under the head 'Income from other sources' [s.39(3)]. However, the provisions of s.39(3) does not apply to an advance payment for the sale of goods or supply of services [s.39(4)]. No adjustment is, therefore, required in the computation of income for the Rs. 4,000,000 received in cash from Carsales Associates as an advance payment for the sale of cars.

Notes:

(3) Rs. 700,000 paid as a donation is not deductible but Mr. Wheels is entitled to a tax credit calculated under a prescribed formula [s.61(1)(b)].

(4) The unpaid amount of Rs. 400,000 for profit on debt (included in sundry creditors) was allowed as a deduction in the tax year 2017 (accounting year ended 30 June 2017). As the amount has remained unpaid for 3 years from the end of the tax year in which the deduction was allowed, the Rs. 400,000 is chargeable to tax in the tax year 2021 (i.e. the first tax year following the end of the said three years).[S.34(5)]

(5) Where the consideration received on the disposal of immovable property exceeds its cost, the consideration received is to be treated as the cost.
The tax profit on the disposal of the building is worked out as under:

			Rs.
Sale consideration			15,000,000
Less:	Tax written down value		
	Deemed cost	15,000,000	
	Depreciation allowed (10,000,000 – 7,000,000)	(3,000,000)	(12,000,000)
Tax profit on disposal			3,000,000

(6) As the debt of Rs. 175,000 written off in the tax year 2020, was not allowed as deduction, the receipt of the Rs. 175,000 is not income chargeable to tax. [S. 70]

(7) Depreciation

	Plant and Machinery	Buildings	Motor Vehicles	Furniture	Total Dept.
Rate of depreciation	**15%**	**10%**	**15%**	**15%**	
	Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**
Written down value	2,700,000	13,800,000	2,500,000	1,570,000	
Disposal	-	(7,000,000)	-	-	
	2,700,000	6,800,000	2,500,000	1,570,000	
Depreciation	405,000	680,000	375,000	235,500	1,695,500
Additions	**4,300,000	-	*2,500,000	-	
Initial allowance	(1,075,000)	-	-	-	1,075,000
Written down value	3,225,000	-	2,500,000	-	
Depreciation (Rate x 50%)	241,875	-	187,500	-	429,375
					3,199,875

*The cost of vehicle is restricted to Rs. 2,500,000.
** It is sum of Rs. 300,000 minor additions and Rs. 4,000,000 (3,500,000 + 500,000)
Note: No depreciation is calculated on disposals as these were purchased before 01.07.2020.

Answer-5

Mr. Waqar
Taxable Income and Tax Thereon
Tax year 2022

Computation of taxable income

				Rupees
Income from business:				
Accounting profit				14,850,000
Add: Accounting depreciation			(5,948,000+1,650,000)	7,598,000
Donation	[S.61]		(Note 6)	300,000
Loan to employee written off	[S.29]			10,000
Income tax paid	[S.21(a)]			1,100,000
				9,008,000
Less: Exempt income				550,000
Provision for bad debs written back	[S.29]		(Note 7)	100,000
Amortisation of pre-commencement expenditure	[S.25(2)]		(3,000,000 x 20%)	600,000
Tax Depreciation	[S.22]		(Note 9)	10,156,875
				(11,406,875)
Taxable income				12,451,125

Items not included in the computation of taxable income

(1) Any expenditure for a single transaction whose amount exceeds Rs. 25,000 and its account head's aggregate total exceeds Rs. 250,000 should be paid through cross cheque etc. otherwise it will not be allowed as deduction, however travel fare is an exception to this rule. The payment of Rs. 300,000 for travel fare therefore is allowed as deduction. [S. 21(l)]

(2) Legal expenses incurred are tax deductible. [S. 20(1)]

(3) Rs. 650,000 paid to a customer is expenditure in the ordinary course of business therefore allowed. Further, the payment is not a fine or a penalty for the violation of any law, rule or regulation.

(4) Rs. 290,000 representing bad debt is allowed as deduction being wholly and exclusively for business. [S. 20(1)]

(5) The Rs. 10,000,000 cost of the computer software is an intangible for tax purposes and has a normal useful life of more than one year. An amortisation deduction is allowed in respect of such an intangible but only if it is used in the tax year in deriving income from business chargeable to tax. As the computer software was not used by Mr. Waqar in its business in the year ended 31 December 2021, there can be no deduction in that year. [S. 24]

Notes:

(6) The donation of Rs. 300,000 to the charitable hospital established under a private trust is not a deductible charge. Tax credit under the provisions of s.61(1)(b) is also not admissible on the amount paid since the hospital is not one that is established or run by the Federal Government or a Provincial Government or a local authority.

(7) As the provision for doubtful debt is not an expense, therefore reversal of provision is also not an income from tax point of view.

(8) Initial allowance.

	Plant and machinery	Computers
	Rs.	Rs.
Total cost shown under fixed assets	17,500,000	20,900,000
Cost of plant previously used in Pakistan	(10,000,000)	–
Cost of software (see note below)	–	(10,000,000)
Eligible for initial allowance	7,500,000	10,900,000
Initial allowance (25%)	1,875,000	2,725,000

Note: Rs. 10,000,000, being the cost of the computer software, has been considered as a fixed asset erroneously, as computer software is considered to be an intangible for tax purposes.

(9) Depreciation

	Plant and Machinery	Buildings	Computer Hardware	Motor Vehicles	Furniture	Total Dept.
Rate of depreciation	15%	10%	30%	15%	15%	
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Cost	17,500,000	15,700,000	10,900,000	12,900,000	18,750,000	
Initial allowance (W-8)	(1,875,000)	-	(2,725,000)	–	–	4,600,000
WDV	15,625,000	15,700,000	8,175,000	12,900,000	18,750,000	
Depreciation (Rate x 50%)	1,171,875	785,000	1,226,250	967,500	1,406,250	5,556,875
						10,156,875

SCENERIO BASED QUESTIONS

Question-1

In the light of the provisions of Income Tax Ordinance, 2001 explain the tax treatment in following independent situations for TY 2016:

(i) Mr. X is engaged in the business of construction and he obtained a loan of Rs 100,000 for purchase of raw material on which he paid interest at 12% during the year.

(ii) Mr Y is engaged in the trading of rice. He received Rs 25,000 in respect of bad debts written off in TY 2015. The whole of debt was 350,000 but tax authorities allowed only 330,000 as bad debt.

(iii) Mr Asghar is in the business of manufacturing toys. He is liable to pay Mr. Ashraf Rs 200,000 for the plastic he purchased. On making an early payment he received a discount of Rs 20,000.

(iv) Mr Ali is involved in providing tax services to corporate clients. He incurred repair expense on the damaged roof of Rs 12,000 in TY 2012 and this amount was allowed as deduction then. This amount is still appearing in balance sheet prepared on June 30, 2016.

(v) Mr Tariq has Textile Mill and he incurred an expenditure of Rs 300,000 on training of workers (who are citizens) to use a new machinery. The training scheme is approved by Board;

(vi) An automobile company has established a school for the children of its employees and incurred electricity expense and salary expense of Rs 500,000 on school for TY 2016.

Question-2

In the light of the provisions of Income Tax Ordinance, 2001 explain the tax treatment in following independent situations for TY 2016:

(i) An IT company's R & D department, considering the importance of innovation in its field, has incurred an expenditure of Rs 900,000 on research. The research is conducted in Australia.

(ii) Mr. Y before starting business spent Rs 300,000 on feasibility report. He also incurred Rs. 100,000 on purchasing of land.

(iii) Mr Asghar paid salary expense of Rs 1,000,000 which include following payments:

Payment to	Mode of payment
Asghar's brother for assisting in office work	Rs. 18,000/month and amount is directly credited in bank account
Asghar himself	Rs. 26,000/month and amount is directly credited in bank account
Mr. Anjum, an accountant	Rs. 26,000/month in cash

(iv) Mr Ali is the business of manufacturing spare parts of cars and he is using a machinery which is taken on a finance lease from a scheduled bank in August 2008. Lease rentals paid during the tax year 2016 amounted to Rs. 220,000. His accounting books show a finance charge of Rs. 50,000 and depreciation of Rs. 120,000.

Required:

Explain the tax implications in each of the above independent situations for TY 2016.

Question-3

In the light of the provisions of Income Tax Ordinance, 2001 explain deductibility/chargeability under following independent situations:

(i) Mr Ali has a Textile mill for which he purchased a vehicle of Rs. 700,000. He is confident that he is entitled for an initial allowance.

(ii) Mr Abid is providing consultancy services since long. During the year he has opened an overseas office in Spain and purchased plant for that office worth Rs. 100,000 on which he intends to obtain initial allowance.

(iii) Mr Saqib has a manufacturing company. He entered into a forward contract for the purchase of raw materials used in its business to guard against loss through price fluctuations. On the date of maturity of the forward contract, he did not take delivery of the raw materials but the contract was settled by a payment of Rs. 950,000.

(iv) Mr Z started construction business in TY 2016. Rs. 800,000 is spent on technical manager's visit to Japan. It was necessary for the firm's technical manager to travel to Japan for selecting a Construction Machine of Rs 2,000,000.The machine was received and it was put to use on May 1, 2016.

Required:

The above are independent situations explain their tax implications for TY 2016

Question-4

In the light of the provisions of Income Tax Ordinance, 2001 explain the tax treatment in following independent situations for TY 2016:

(i) Mr X is running a furniture business. He gave Rs. 150,000 scholarship to Mr. Muneer a citizen of Pakistan, for his technical training in connection with a scheme approved by FBR. Mr. Muneer is not an employee of Mr X.

(ii) Atlas and Co is a registered automobile manufacturing company. It outsourced its maintenance of record of shares. The total expense incurred was Rs. 800,000 including the fee paid of Rs. 555,000 to increase the company's authorized capital.

(iii) Y Ltd has a consultancy business. It incurred repair expense of Rs 12,000 which was allowed as deduction in TY 2010. The expense was unpaid till TY 2014 so tax authorities added this amount in income in TY 2014. The expense is subsequently paid in TY 2016.

(iv) The books of M & M leasing company shows a receivable of Rs. 200,000 from Mr. A. The money was collected by Special purpose vehicle (SPV) on behalf of M and M. SPV paid M and M Rs. 195,000 after deducting commission of Rs. 5,000. M and M is unsure about the treatment of Rs. 5,000.

(v) Revenue Ltd. is engaged in manufacturing business. It revalued its building in accordance with International Accounting Standards and consequently charged depreciation on the revalued amount.

SCENERIO BASED QUESTIONS SOLUTION

Answer-1

(i) According to S. 28(a) a deduction shall be allowed for a tax year for any profit on debt paid by a person, if loan is used in business.
The loan is used for business purpose that's why interest on loan 12,000 is a deductible expenditure

(ii) According to S. 29 where the bad debt recovery is greater than the difference between:
- the whole of bad debt and
- the amount previously allowed as a deduction,

The excess shall be included under "Income from Business" in the tax year in which it is received"
Following amount is chargeable to tax.

		Rs.
Tax bad debt recovery		25,000
Amount Received	350,000	
Actual bad debts	(330,000)	
Less: Amount previously allowed as deduction		(20,000)
		5,000
Taxable amount		

(iii) As per S.34(5A) where a deduction is allowed for trading liability and person derives any benefit against it, the benefit shall be chargeable under "Income from Business" in year of receipt, therefore the discount received of Rs. 20,000 will be chargeable to tax.

(iv) As per S.34(5) Where a deduction is allowed for any expenditure in "Income from Business" and the person has not paid the liability within 3 years of the end of the tax year in which the deduction was allowed, the unpaid liability shall be chargeable under the head "Income from Business" in the first tax year following the end of the 3 years. Therefore Rs. 12,000 will be charged to tax in TY 2016.

(v) As per S.27(c) a person shall be allowed a deduction for expenditure (other than capital expenditure) incurred for the training of a citizen of Pakistan, in connection with a scheme approved by the Board. Therefore the said amount is allowed as deduction under the head income from business.

(vi) As per S. 27 a person shall be allowed a deduction for expenditure (other than capital expenditure) incurred for any educational institution or hospital in Pakistan established for the benefit of the employees and their dependents. Therefore Rs. 500,000 is allowed as deduction.

Answer-2

(i) As per S.26 a deduction will be allowed for scientific research expenditure in Pakistan wholly and exclusively for business.
As the research is incurred in Australia so it is not allowed as deduction.

(ii) Preparation of feasibility study is a pre commencement expenditure as per **S.25.** It shall be amortized on a straight- line basis at the rate of 20%. So a deduction of amortization of 60,000 (300,000 x 20%) of pre-commencement expenditure will be allowed. However purchase of land is a capital expenditure so no deduction will be allowed in this respect.

(iii) As per S.21 following deductions will not be allowed under the head "Income from Business"-
(m) any salary paid exceeding Rs. 25,000/month otherwise than by:
- a crossed cheque or
- direct transfer of funds to the employee's bank account

(h) any personal expenditures incurred by the person;
Salary to Asghar's brother being paid through bank transfer is allowed as deduction.
Salary to Mr Asghar is not allowed as deduction being personal expenditure.
As salary to Mr. Arjum is paid in cash and exceeds Rs. 25,000/month. Therefore it will not be allowed as deduction.

(iv) As per S.28 deduction shall be allowed for a tax year for lease rental paid by a person to a bank, leasing company for asset used in business
In case of assets taken on finance lease, lease rental is an admissible deduction whereas depreciation and finance charge will not be allowed as deduction.

Answer-3

(i) As per S.23 no initial allowance will be allowed on road transport vehicle(other than transport vehicle plying for hire);
According to above provision no initial allowance will be allowed however normal depreciation will be allowed on vehicle.

(ii) As per S.23 initial allowance is only allowed on assets used in Pakistan. Accordingly, the company will not be entitled to deduct initial allowance on asset used outside Pakistan. However normal depreciation will be allowed.

(iii) As per S.19 "speculation business" means a business in which a contract for the purchase and sale of a commodity (including stocks and shares) is not settled by actual delivery of commodity.
However where a contract for stock is made by a person during mercantile business to guard against loss through future price fluctuations for fulfilling the person's other contracts for the actual delivery of the goods than it will not be considered as speculation business.
So this contract being of hedging nature is not included in the definition of speculative business. Therefore, Rs.950,000 paid to settle the forward contract is an expenditure incurred in the normal course of business and is deductible in normal income from business.

(iv) As per S.21 any expenditure paid of a capital nature is not allowed as deduction under the head "Income from Business". However depreciation or amortization deductions will be allowed.
The expenditure of Rs. 800,000 incurred solely to secure the purchase of a mixing machine is a capital expenditure and is not deductible. However initial allowance and depreciation will be allowed. The cost of the asset is Rs. 2,800,000 (2,0000,000 + 800,000). Depreciation and initial allowance will be allowed for full year.

Answer 4

(i) As per S.27A person shall be allowed a deduction for expenditure incurred for the training of a citizen of Pakistan, in connection with a scheme approved by the Board.
Since the scholarship has been granted to a Pakistani citizen for his technical training under a scheme approved by the Federal Board of Revenue, the expenditure is admissible. The beneficiary of the scholarship does not need to be an employee of the taxpayer.

(ii) Any expenditure paid of a capital nature will not be allowed under the head "Income from Business". Therefore the fee paid of Rs. 555,000 to increase authorized capital is a capital expenditure in nature, hence not allowable. The remaining expenditure (10,800,000 – 550,000) being revenue in nature is admissible.

(iii) As per S.34(6) where an unpaid liability is added in income and the person subsequently pays the liability, a deduction will be allowed in the year of payment.
According to above said provision, the expense of Rs. 12,000 is allowed as deduction in TY 2016.

(iv) As per S.28 the financial cost of the securitization of receivables being the difference between the:
- amount receivable by the Originator (lessor) and
- the amount received from SPV (Special Purpose Vehicle)

is allowed as deduction in the books of lessor.
Therefore Rs. 5,000 is allowed as deduction in the books of M and M.

(v) Depreciation is calculated by applying rate on written down value of asset. Accounting revaluation of assets has no effect on tax written down value of assets. Therefore we will ignore the revaluation surplus and will keep on charging depreciation on written down value.

OTHER QUESTIONS

a)	Which of the expenses are not allowed as deduction on the basis of mode of payment	Sec. 21 (l) (m)
b)	Which of the expenses are not allowed on the basis of non-deduction of tax?	Sec. 21 (c)
c)	What is the treatment of bad recovery income appearing in the accounting profit and loss?	Sec. 29 (3)
d)	What is the tax treatment of discount received from creditors?	Sec. 34 (5A)